

AR81

Annual Report 2005
SOUTHWESTERN RESOURCES CORP.



2005

Accomplishments

Scoping study completed
at Boka Gold Project

Pre-feasibility study
initiated at Boka Gold Project

Liam Project identified as
gold-silver district

Liam Joint Venture expanded
to **367,000 hectares**

Initial reconnaissance drilling
at Farallon/Astana zones,
Liam Project

Pre-feasibility study
initiated at Accha-Yanque Project

Initial reconnaissance drill
programs at Capayocc and
Azulcancha, Accha-Yanque Project

Anglo American defines
extensive porphyry target at
the Ccora Sur Zone, Antay Project

2006

Goals

Complete pre-feasibility
study at Boka Gold Project

Expand resources at
Boka Gold Project

First phase drill program,
other targets, Boka Gold Project

Complete pre-feasibility study
at Accha-Yanque Project

Expand resources at
Accha-Yanque Project

First phase drilling at
Careli Zone, Liam Joint Venture

In-fill and step-out drilling
at Cerro Crespo, Liam
Joint Venture

First phase drilling
program at Antay Project

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Letter to Shareholders

Once again in 2005, **Southwestern Resources** experienced a busy year of exploration and development on several key projects in China and Peru. A major milestone for your Company was the delivery of a Preliminary Assessment Report by Hatch Limited on the **Boka Gold Project** located in southern China. The Preliminary Assessment Report concluded that the Boka Gold Project was one of the significant gold discoveries of the past few years and should immediately progress to the pre-feasibility stage. At Boka, the Company has a 90% interest through its shareholding in Yunnan Gold Mountain Mining Co. Ltd., the Sino-Foreign Joint Venture Company that owns the exploration concessions and mining leases covering the Boka mineralization. Our partner, Team 209 of the Yunnan Nuclear Industry, has a carried 10% interest in the Joint Venture Company. Yunnan Gold Mountain Mining Co. Ltd. has a 25 year business license.

Our success at Boka is a direct reflection of the quality of the Company's technical personnel operating in China. Southwestern has been in China for 10 years and with recent permitting of foreign-owned mines, the Company is committed to fully advance this Project for the benefit of all shareholders into a world-class gold mine. The Company has now progressed into a full pre-feasibility study under the guidance of Ausenco Limited, a world-renowned engineering firm with extensive experience building gold mines in Asia. This comprehensive study will address various issues including resource evaluation, mine planning, geotechnical and hydrological work, detailed metallurgy and flow sheet development, tailings, environmental and social impact of a mine, and general logistics. Ausenco is a world leader in mine development in China and together with Golder Associates Pty Ltd. and SRK Consulting Engineers and Scientists, two other consultants on the pre-feasibility study, has extensive experience working in a cooperative manner with Chinese governmental groups, which will be invaluable to the advancement of the Project.

In addition to the Boka Gold Project, Southwestern is also exploring similar types of gold prospects in Sichuan Province to the north of the Project. Several targets have been defined and occur within areas under application by the Company's Wholly Owned Foreign Enterprise (WOFE). Once the concessions are granted, an aggressive exploration program is planned. The Company is also exploring, through a 50/50 Joint Venture with Newmont Overseas Exploration Limited, an extensive area in northern Yunnan Province with potential to host copper-gold porphyries and alkaline related gold systems. The first phase program is 70% completed and a number of important gold systems have been identified and will undergo aggressive evaluation in 2006.

Although our success at the Project in 2005 was tremendous, significant achievements were also made in Peru on our Liam, Accha-Yanque and Antay projects. Our team at the **Liam Project**, a 50/50 Joint Venture with Newmont Peru Limited, has identified and evaluated several large gold-silver epithermal systems within the Joint Venture area, resulting in the recognition of Liam as being a new precious metals district. As a consequence, the Liam Joint Venture landholdings were expanded several times during 2005 and now total 367,000 hectares, representing the largest exploration concession block in Peru. Nine gold-silver systems have now been identified within the Joint Venture area and a series of drill programs have been initiated to test the most promising prospects.

The Company has made great strides over the past year on the **Accha-Yanque Project**. A pre-feasibility study was initiated mid-year with the initial priority to retain world-renowned experts in the treatment of zinc-oxide ores to evaluate all of the Accha metallurgical data. Their conclusions were that the Accha zinc-oxide mineralization was amenable to SX-EW treatment to produce zinc cathode. This treatment process has now been shown at Anglo American's Skorpon Mine to be a low-cost method

for producing zinc metal. The proximity of the Project to the township of Accha means working closely with the local residents in a cooperative manner to bring the Accha mineralization to a successful mining stage. It is a credit to our Peruvian management team that the Company has been able to sign a definitive agreement with the Accha community allowing for the advancement of this important Project. In addition to infill and resource expansion drilling at Accha, as part of the pre-feasibility study, a drilling program will also be initiated at several other zinc-oxide prospects in the district including Yanque. Management of the Company believes that the Accha-Yanque Project has all the essential ingredients to become an important zinc producing area and your Company will work hard to achieve this goal.

One of Southwestern's main targets over the years for generating new opportunities in Peru has been the Tintaya-Bambas copper-gold skarn-porphyry belt. This prolific belt has been recognized in recent years as an important target for the discovery of new porphyry copper deposits. Our success in discovering the Antay porphyry copper-molybdenum system and the recent success in discovering and expanding porphyry deposits in this belt have substantiated the labelling of the belt as the next great porphyry copper district in the world. As with all new discoveries of large mineralizing systems and the lack of world-class properties, the Company was inundated with joint venture enquiries from major companies. Management's decision to reduce shareholder risk on the **Antay Project** resulted in the formation of a joint venture with Anglo American to further advance the Project. In 2005, Anglo American completed an exploration program on the Ccora Sur porphyry system located in the southern portion of the Antay Project area. Anglo American's work has defined a large porphyry target enhanced by an induced polarization geophysical survey that has delineated a prominent chargeability high with depth extension to over 500 metres and covering an area 2.5 kilometres by 1.2 kilometres. The Ccora Sur porphyry system and specifically this large chargeability anomaly will be the focus of the first phase of drilling in the first half of 2006.

With the transition of several projects from early stage to pre-feasibility, management is carefully planning for growth. Importantly, the Company has been able to

attract several top professionals with extensive mine development evaluation experience to enhance the depth of our management team. With more and more opportunities of an advanced nature being presented to the Company, these professionals bring a wealth of knowledge on the valuation and operations side of the business and are an important part of Southwestern's team building in addition to our exploration, financial and legal expertise.

It is management's view, mainly due to the unprecedented economic growth in China and India, that the world is entering a new long-term cycle of commodity shortages, especially metals. For this reason, we anticipate that **metal prices will continue to increase** well into the future. Southwestern is well positioned to take full advantage of the **growing demand for metals**. Although the Company has an enviable portfolio of prospects, we will continue to identify new opportunities to acquire quality assets to add shareholder value. Our strong financial position allows us to take full advantage of these opportunities.

Over the past year, your Company has taken significant steps to strengthen our policies with respect to corporate governance and regulatory requirements. Of most importance are the initiatives taken to strengthen the Company's internal and disclosure controls and to fulfil all of the requirements within Sections 404 and 302 of the Sarbanes-Oxley Act. Southwestern's management and financial team is dedicated to implementing these controls and setting the highest standards possible.

I would like to acknowledge and thank our shareholders for their continued support during the past year. I would also like to thank our many dedicated employees and management personnel for their work in making the past year such a successful one. I look forward to even greater challenges and successes in the year ahead and am confident that the dedication of our people will benefit all shareholders.



John G. Paterson
President & Chief Executive Officer

March 13, 2006

Project Review

BOKA GOLD PROJECT

Yunnan Province, China



The Boka Gold Project

is underlain by several extensive gold mineralizing systems hosted in Middle to Upper Proterozoic sediments within the structurally complex Panxi Rift of Central Yunnan Province in southern China. The Project is located about 265 kilometres by road north of the capital city of Kunming and is the subject of a Sino-Foreign Joint Venture contract between a Southwestern subsidiary and Team 209 of the Yunnan Nuclear Industry of Yunnan Province ("Team 209"). The joint venture company (Yunnan Gold Mountain Mining Co. Ltd.) is owned 90% by Southwestern and 10% by Team 209. Southwestern is contributing 100% of the exploration funds with Team 209 retaining a 10% carried interest in the joint venture company, which has a 25 year business license. The Boka Gold Project is comprised of three exploration concessions and three mining licenses covering

157 square kilometres. These concessions and licenses are registered in the name of the joint venture company.

Several extensive gold mineralizing systems have been identified within the Project area along the western edge of a north-south trending plateau bounded by the Xiaojiang River to the east and the

Excavating drill pads, Boka 1



Highlights of the 2005 drilling results

Hole No.	Core Interval (metres)	Grade (g/t Au)
B05-78	65.10	3.3
B05-80	63.15	5.8
B05-84	42.90	3.4
B05-92	24.50	3.6
B05-101	36.10	3.8
B05-105	54.55	3.6
B05-111	99.77	4.2
B05-112	56.00	1.3
B05-113	53.30	1.7
B05-120	42.20	2.8
B05-127	27.10	3.8
B05-129	47.20	1.7
B05-136	26.00	2.3
B05-139	46.00	2.7
B05-148	69.10	2.3
B05-149	59.00	2.2

Yangtze River to the west. The central plateau sits at an elevation of approximately 1,900 metres. In addition, results of the soil sampling program have defined numerous gold and copper anomalies.

The Boka Project is easily accessible by paved highway and gravel road from Kunming. The Provincial government is currently undertaking a major upgrading of roads in this area and, by mid-2007, modern paved highways will be completed from Kunming to approximately 6 kilometres east of the Boka Project area.

During 2005, the Boka Project was the subject of an extensive drilling program focused mainly on the Boka 1 Gold Zone. From inception to the end of 2005, Southwestern has completed 156 holes totaling approximately 62,000 metres with the majority of this drilling carried out at Boka 1 on a 50 metre by 50 metre spacing.

An important milestone reached on the Project during 2005 was the completion of a Preliminary Assessment Report (scoping study), prepared by Hatch Limited, an internationally recognized engineering firm. The Hatch assessment was based on the first 67 drill holes and in view of subsequent

BOKA 1 NORTH

Large Scale Structures Controlling Gold Mineralization



Drilling on Boka 1 North



Mineral Resource Estimate

As of April 27, 2005
(0.5 g/t Au cut off, cut to 31 g/t Au)

BOKA 1 NORTH

		(Cut)	(Uncut)
Indicated	4.8 Mt at 2.98 g/t Au	= 0.46 Moz	(0.49 Moz)
Inferred	15.9 Mt at 2.75 g/t Au	= 1.41 Moz	(1.45 Moz)

BOKA 1 SOUTH

Indicated	5.7 Mt at 2.79 g/t Au	= 0.51 Moz	(0.54 Moz)
Inferred	15.4 Mt at 2.75 g/t Au	= 1.36 Moz	(1.65 Moz)

BOKA 7

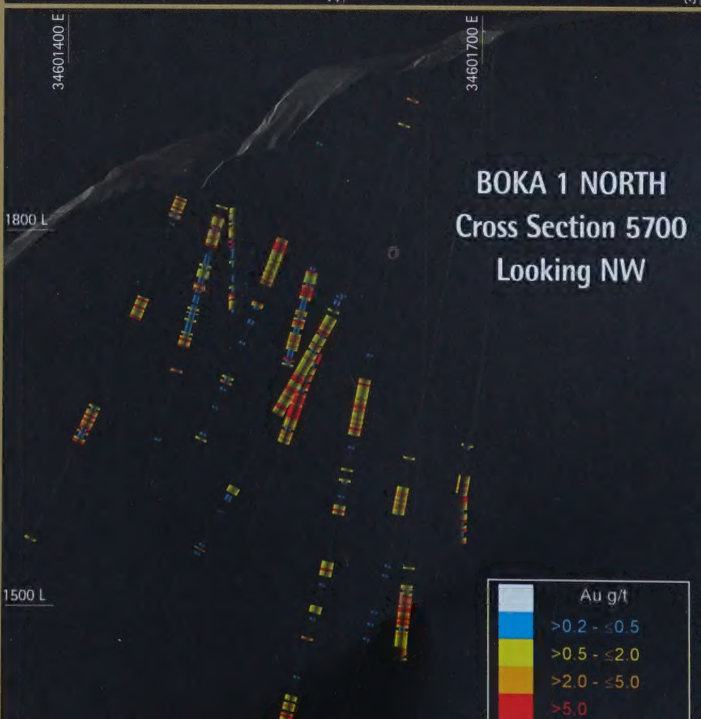
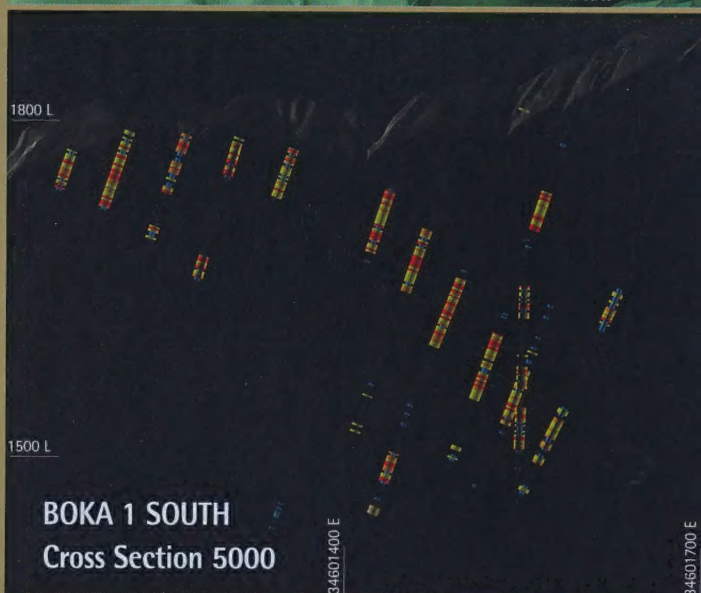
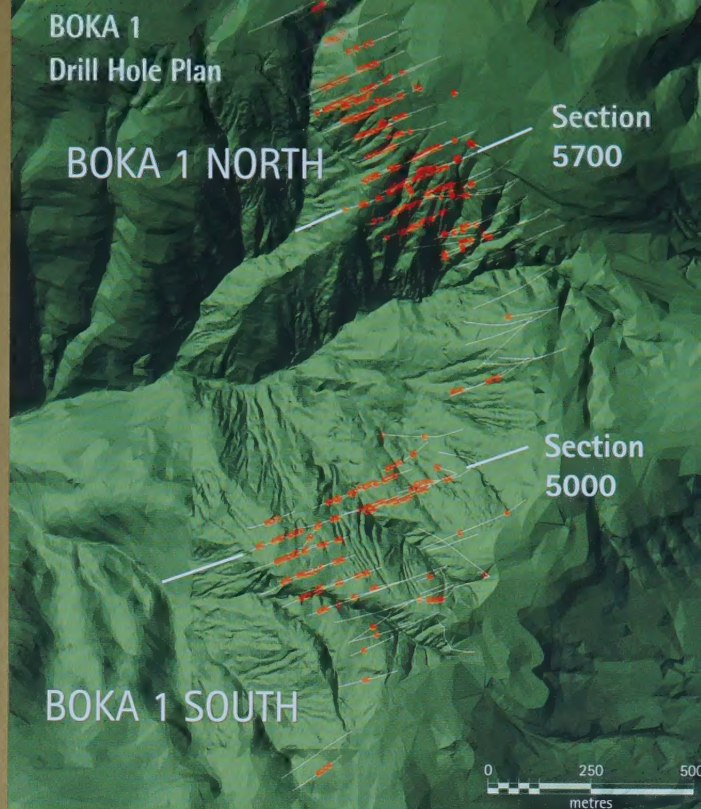
Inferred	14.5 Mt at 2.75 g/t Au	= 1.28 Moz	(1.28 Moz)
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Totals

Indicated	10.4 Mt at 2.88 g/t Au	= 0.97 Moz	(1.06 Moz)
Inferred	45.8 Mt at 2.75 g/t Au	= 4.05 Moz	(4.38 Moz)

IN-PIT RESOURCES

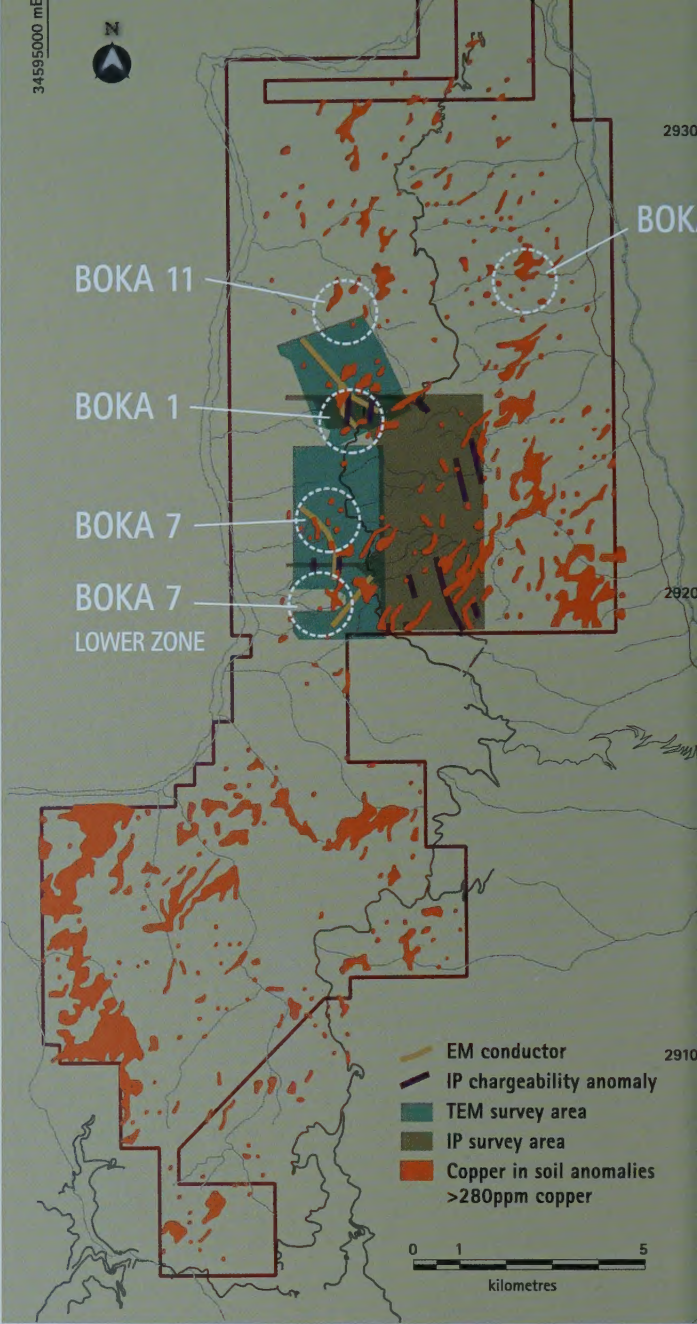
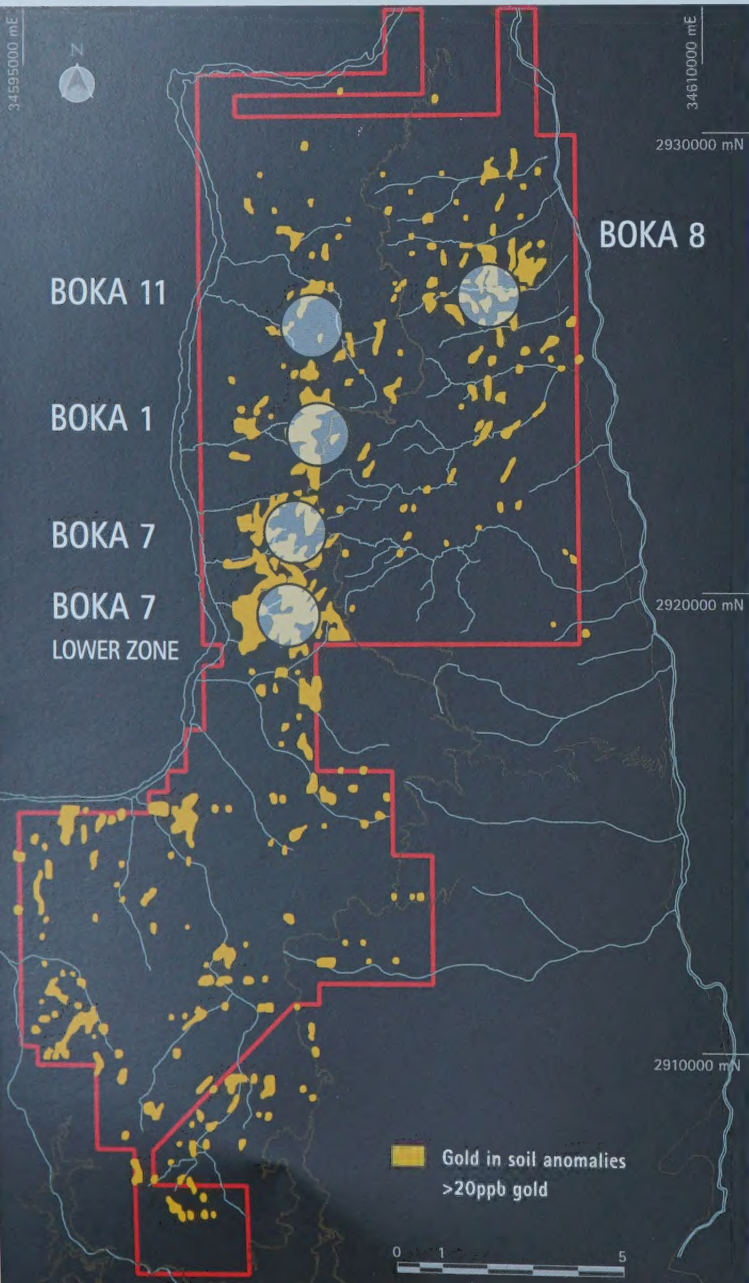
Indicated	5.1 Mt at 2.93 g/t Au = 0.48 Moz
Inferred	18.1 Mt at 2.93 g/t Au = 1.71 Moz
Metallurgical Recovery	+90%
Mill Capacity	2.4 million tonnes per year
Overall Strip Ratio	6.7 to 1
Open Pit Mine Life	10 years
Gold Production	200,000 ounces per year
Operating Cost	US\$12.11 per tonne of ore
Cash Cost	US\$143 per ounce of gold
Capital Cost Estimate	US\$174 million



drill results it is management's opinion that the resources and mine plan set forth by Hatch may be conservative. The Hatch Report recommended that the Company should immediately commence

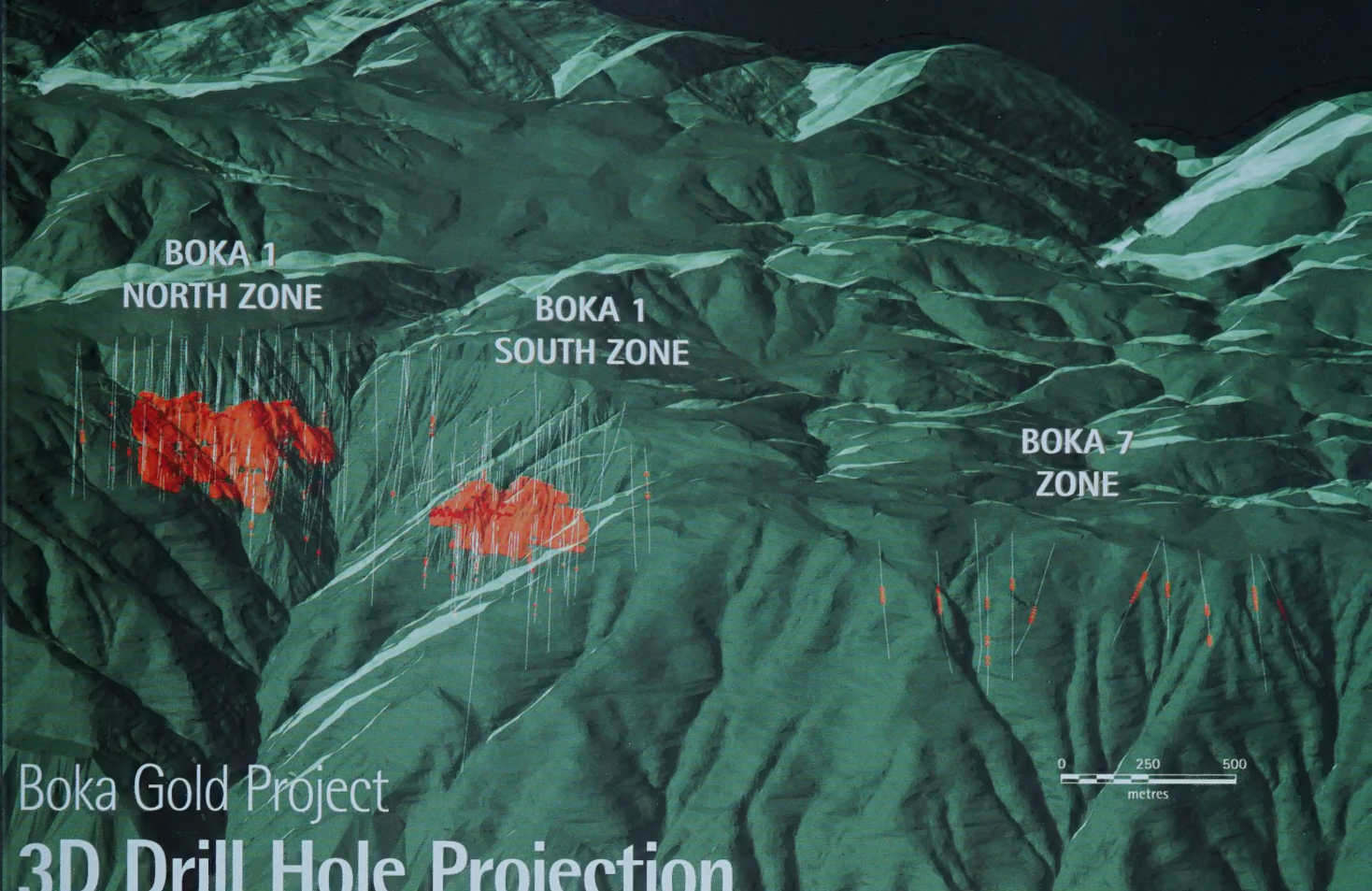
Hatch Preliminary Assessment Report completed - An important milestone

a pre-feasibility study on the Boka Gold Project and concluded positively on the scope for developing a mining operation with a capacity to support



production levels of 200,000 ounces of gold per annum. The study envisages an open pit operation and also highlights underground mining operations for future consideration. In terms of processing, initial metallurgical test work shows that the mineralization is free-milling, and conventional Carbon in Leach process testing resulted in greater than 90% recoveries. Metallurgical test work is ongoing.

Site layout as proposed in the scoping study, outlines three tailings facilities within uncultivated zero discharge basins. The proposed tailings facilities are located up to 6 kilometres from the



BOKA 1
NORTH ZONE

BOKA 1
SOUTH ZONE

BOKA 7
ZONE

0 250 500
metres

Boka Gold Project 3D Drill Hole Projection

plant site, and have the capacity to contain 175 million tonnes of material. Two waste dump sites have been identified within 1 to 3 kilometres from the mine site to create as little disturbance as possible within and around the township of Boka. Hauling of waste and sub-grade material from pits at a lower elevation to dumps above and away from drainage can be accomplished by a series of overland conveyors. The main power grid, located 1.5 kilometres east of the mine site, has a capacity of 150,000 kva and is more than sufficient to support the modelled mining operation.

The Company has awarded the pre-feasibility study to Ausenco Limited, an internationally recognized Australian firm that specializes in the provision of engineering construction and project management services to the mining and mineral processing industry, mainly in the Asian region. Ausenco was the lead engineering firm for the development of SinoGold's Jinfeng Mine, the largest foreign owned

gold mine in China. Subcontractors for specialty areas such as environmental, tailings disposal, pit design and resource evaluation include Golder Associates and SRK Consulting.

The current 50 metre by 50 metre drilling program on the Boka 1 Gold Zone is nearing completion and in 2006, the program will focus on step-out drilling at Boka 7 and preliminary testing of other significant gold mineralizing systems within the Project area. A number of new targets and identified areas of gold mineralization have been defined through prospecting and exploration surveys, including geochemical soil sampling (27,000 samples taken on a 200 metre by 100 metre grid), 42 line kilometres of Transient Electromagnetics, 157 kilometres of ground magnetics and 27 kilometres of induced polarization geophysics.

LIAM GOLD-SILVER

Project, Peru

367,000 hectares -
The largest single
claim block
in Peru

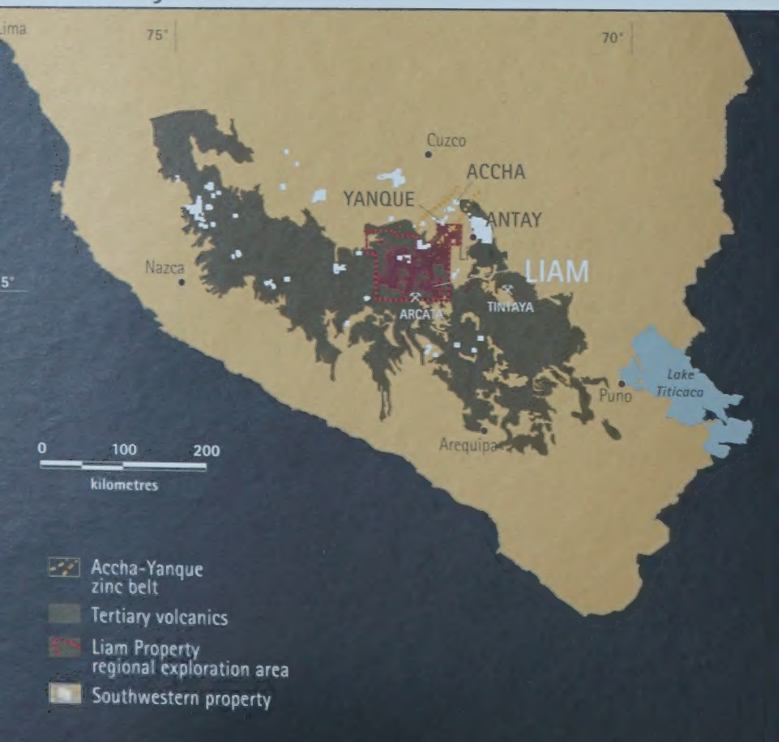
Cerro Crespo ridge in background

The **Liam Project** is situated in the Department of Cuzco in the southern portion of the Peru Tertiary Volcanic Belt and located 170 kilometres northwest of Arequipa. The Project is a 50/50 Joint Venture with Newmont Peru Limited, and after several land expansions during 2005, comprises 367,000 hectares of exploration concessions, making it the largest single claim block in Peru. The Liam Project lies within the Peruvian Altiplano at an altitude of 4,470 metres to over 5,000 metres and is accessible by gravel road from the mining community of Orcopampa.

The exploration program by the Joint Venture partners has been successful in identifying nine gold-silver zones of various types hosted within Tertiary volcanics and Cretaceous sediments. All of the Tertiary volcanic hosted gold-silver occurs within the Alapabamba Formation, a complex sequence of bedded volcanic flows and pyroclastic rocks.

The Liam Project represents a newly discovered mineral district in southern Peru and a number of the more significant zones of mineralization to date are outlined below.

Liam Project Area



Cerro Crespo

Cerro Crespo outcrops as a prominent northwest-southeast trending ovoid shaped ridge with near vertical walls. The mineralized ridge is comprised of hydrothermal and magmatic breccias containing vuggy silica, alunite and hematite/limonite typical of a high sulphidation epithermal gold-silver mineralizing system. Extensive surface sampling, geophysical surveying and a total of 33 drill holes comprising 5,103 metres have been completed at Cerro Crespo. Silver-rich and gold-rich zones

were encountered in the surface sampling and in drill holes from surface to a depth of 212 metres. Certain areas of Cerro Crespo remain to be drilled once access roads are completed. One of these areas includes a new zone of anomalous gold-silver mineralization defined over a 100 metre by 100 metre area identified in the 2005 sampling program. Drilling this new zone and infill drilling on the main mineralized zone are planned for 2006.

Cerro Queshca

Cerro Queshca is located 1 kilometre north of Cerro Crespo and is underlain by six zones of gold-silver mineralization of high sulphidation type within strongly silicified volcanics. A total of 4,617 metres in 33 holes has been drilled at Cerro Queshca to date. Interpretation of the drill results suggest that the zones of high grade gold-silver mineralization outcropping at surface are isolated remnants of a larger eroded mineralization. In several holes, high-grade gold mineralization has been intersected and normally is associated with intense silification and late limonite/hematite filled fractures. The Cerro Queshca prospect is presently undergoing a data review and further work will depend on a positive interpretation of the data.

Farallon

Located approximately 10 kilometres southwest of Cerro Crespo, Farallon is a large epithermal system of low sulphidation gold mineralization extending for 1,000 metres by 800 metres. The zone outcrops as a prominent ridge trending northwesterly and is overlain by younger post mineralizing volcanics to the north and east. The Joint Venture completed an extensive rock chip and soil sampling program at Farallon in 2005. This program returned surface gold grades in the order of 0.2 to 0.5 grams per tonne gold with isolated areas ranging between 2.0 to 5.0 grams per tonne gold.

A preliminary drilling program was completed at Farallon in late 2005 and results are pending.



SOUTHWESTERN-NEWMONT

LIAM JOINT VENTURE

Southwestern-Newmont
Claim Holdings



Mobilizing drill rig, Cerro Quesneca

Careli

The Careli gold-silver mineralized zone is located 30 kilometres northeast of Cerro Crespo and outcrops poorly along a northwest-southeast trending prominent dome shaped ridge extending for 700 metres along strike and 200 metres wide. This zone has a coincident high resistivity geophysical anomaly associated with it and suggests that this anomaly is a function of the strong silification of the host rocks, and extends from surface to 150 metres depth.

Further detailed surface work carried out in 2005 has identified a new gold zone to the east of Careli. This zone is also associated with a high sulphidation epithermal system in volcanic rocks.

First phase drilling of the Careli gold zone is planned for the second quarter of 2006.

Reconnaissance exploration in the Accha-Yanque Belt

Huacullo

Huacullo is located 20 kilometres northwest of Cerro Crespo and is underlain by Cretaceous sediments and Tertiary volcanics. A number of different types of gold mineralization occur in the area and include mineralized quartz veins and disseminated mineralization in sediments, epithermal veins and breccia structures in volcanics.

The hydrothermal breccia structures range in width from 0.5 to 6.0 metres and extend for up to one kilometre in length. The breccias are comprised of both Cretaceous sedimentary and Tertiary volcanic fragments in a silica matrix. Of the 42 rock chip samples collected across these structures, 11 samples reported values ranging from 0.5 grams per tonne gold to 19 grams per tonne gold. In addition, several mineralized quartz vein systems have been discovered and extend discontinuously over a 1,200 metre strike length. Widths of individual veins range from 0.4 metres to 10 metres. Although the rock chip sampling program in 2005 was not extensive, a total of 46 samples were collected in the vein structures with 26 of the values ranging between 0.12 and 1.9 grams per tonne gold and 1.2 to 109 grams per tonne silver. These structures are also anomalous in molybdenum.





ACCHA-YANQUE ZINC

Accha-Yanque Project Area

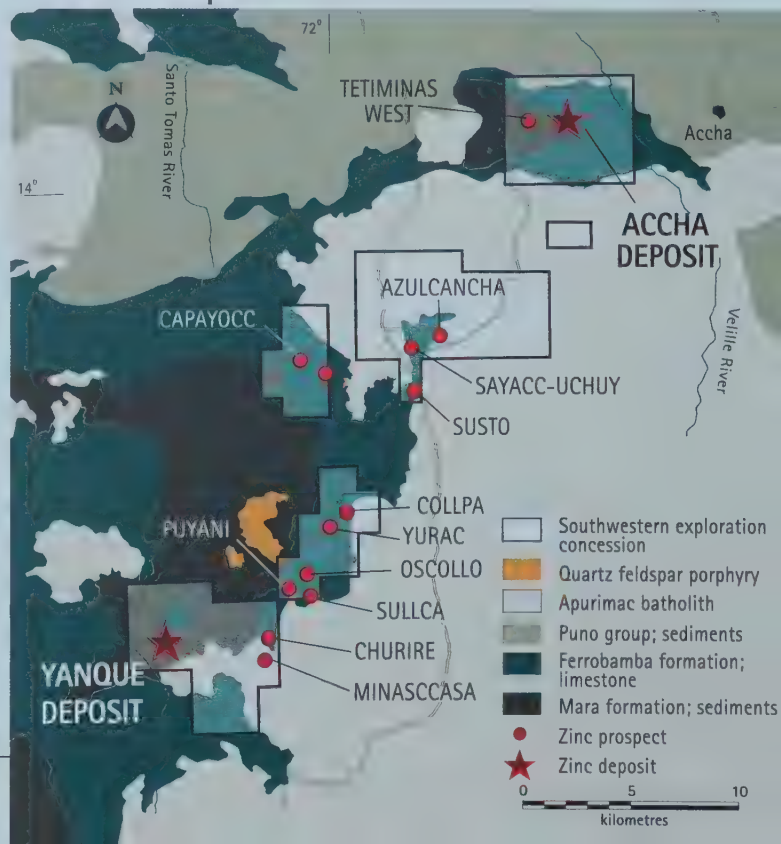
The Accha-Yanque Zinc Project

extends for approximately 35 kilometres in a northeast trending zone hosting multiple zinc-oxide occurrences along the western margin of the Apurimac Batholith, in southern Peru. Southwestern owns 100% of 11,929 hectares of exploration concessions extending from the Accha Zone in the northeast to the Yanque Zone in the southwest. Nine zinc-oxide prospects have been identified within this belt. Drill programs have been conducted at Accha and Yanque resulting in delineation of significant bodies of zinc-oxide mineralization. In late 2005, initial drilling was completed on two new areas of zinc-oxide mineralization at Capayoc and Azulcancha.

The Accha Zone was previously under option to Savage Resources Ltd. (subsequently taken over by Pasminco Ltd.) and a scoping study was completed under the JORC Australia guidelines for resource estimation. In the scoping study, Savage Resources concluded that the Accha mineralized zone contained 7 million tonnes of 9% zinc in the indicated category and 2 million tonnes of 9% zinc in the inferred category. This resource estimate is historical and the Company is not treating the estimate

as National Instrument 43-101 defined resources. The Company has not completed the work necessary to verify the classification of the resources and therefore such historical estimates should not be relied upon. Historical drilling by RTZ at the Yanque prospect returned significant intersec-

Accha-Yanque Zinc Belt



tions of zinc-oxide mineralization including 23.1 metres of 6.28% zinc and 25.8 metres of 7.8% zinc in hole YAD-004. Drill spacing at Yanque is in the order of 150 metres up to 350 metres and the mineralization remains open.

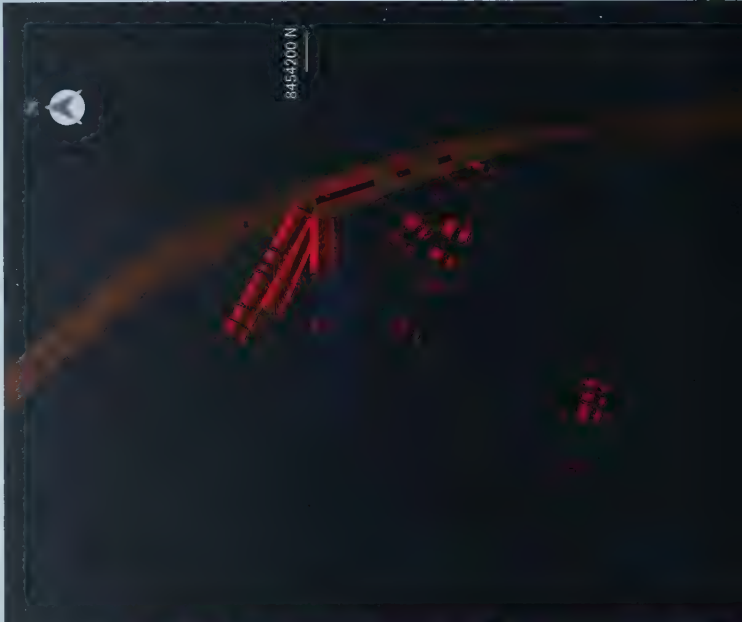
In 2005, substantial increases in the zinc price prompted management to initiate a pre-feasibility study on both Accha and Yanque. As part of the pre-feasibility study, major drill programs will be carried out at Accha and Yanque in 2006. An aggressive exploration program in 2006 will address the potential of other new zinc prospects within the Project area and also focus on discovery of new mineralization.

Zinc-oxide mineralization at Accha occurs within an east-west trending stratabound breccia in the Ferrobamba Formation limestones extending for 300 metres in length and up to 150 metres width. Drilling has extended mineralization a further 300 metres west although this zone does not outcrop. As part of the pre-feasibility study, drilling will focus on defining the limits of the deeper mineralization intersected to the west of the main open pittable resource. This deeper zinc-oxide can be accessed by tunnelling from the north slope of a prominent ridge.

In 2006, the Company mandated a review of the Accha metallurgical test results by three groups with expertise in zinc-oxide treatment. All three groups concluded that the Accha zinc-oxide mineralization was amenable to a process of acid leaching and electrowinning (SX-EW) to produce zinc cathode. This technique has been proven at Anglo American's Skorpion Mine in Namibia to be a low-cost method for producing zinc metal. Other issues to be addressed in the pre-feasibility study include geological modelling, resource calculations, environmental/social issues, logistics and mine planning.



Accha Drill Plan – Mineralized Intersections



Section 186950 E



3D Projection, Accha Zinc Mineralization

ANTAY COPPER-MOLYBDENUM

Porphyry Project Peru



Antay Project Area

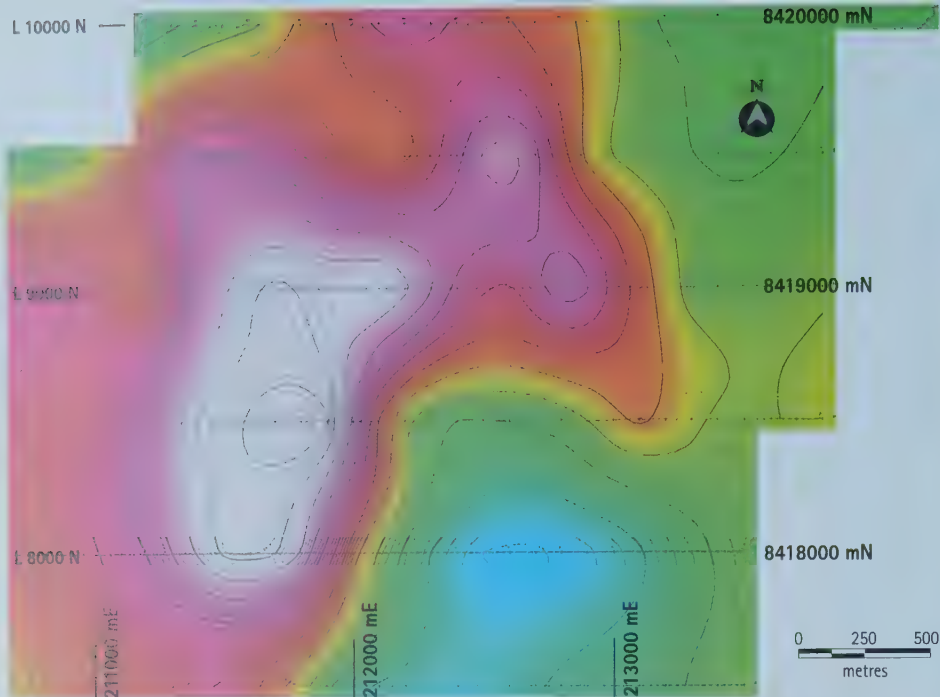
The **Antay Copper-Molybdenum Porphyry Project** is located within the prolific Tintaya-Bambas Copper Belt and is accessible by road from the city of Cuzco located 150 kilometres northwest of the Project Area. Southwestern discovered the Antay Porphyry system during systematic evaluation of the Tintaya-Bambas Belt and located two large outcropping porphyry systems: one in the north portion of the concession block (Sayta) and one in the south portion of the concession block (Ccora Sur). The porphyries are hosted by Cretaceous quartzites that are overlain unconformably by Tertiary ignimbrites (volcanic rocks).

Location of Porphyry Centres and Concessions



In June 2005, the Company signed a Letter Agreement with Anglo American Exploration Peru S.A. to further advance the Antay Project. Under the terms of the Letter Agreement, Anglo can earn a 70% interest in the Antay Project by completing a bankable feasibility study and subscribing for US\$5 million in Southwestern shares.

Exploration work by Anglo American has focused on the south portion of the Antay Project at the Ccora Sur porphyry system. Anglo American completed an extensive sampling and mapping program that identified anomalous copper-molybdenum mineralization within highly leached porphyry and locally strong limonite veining in the host quartzite. Interpretation of the alteration assemblages within the porphyry suggest that the mineralization at Ccora Sur represents the top portion of a copper-molybdenum porphyry system. An induced polarization geophysical survey completed across the Ccora Sur Zone confirmed



The Antay Project – World-class copper potential

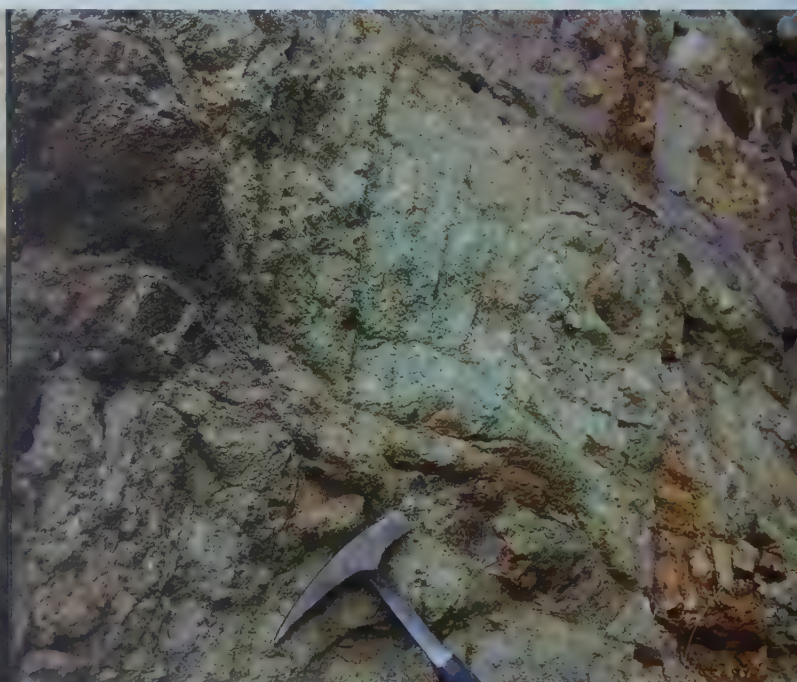
Ccora Sur Chargeability Anomaly, Antay Project

the presence of a large chargeability anomaly over an area of 2.5 kilometres by 1.2 kilometres and extending to over 500 metres depth. Indications of sulphides are only seen in the porphyry and Anglo American geologists have interpreted the chargeability anomaly to be related to porphyry-type mineralization.

A planned drilling program to test the Ccora Sur chargeability anomaly is in the permitting stage and is anticipated to start in the second quarter 2006.

In the north portion of the Antay Project, the Sayta porphyry copper-molybdenum mineralization is exposed in places over a vertical distance of 400 metres. This has allowed sampling to be carried out within deeper portions of the system. Results of the sampling show a consistent increase in copper-molybdenum grades with depth. Anglo will be initiating an aggressive exploration program in the Sayta porphyry in 2006.

Left: Quartz-molybdenite-chalcopyrite stockwork in silicic-sericitic alteration, Antay Project
Right: Copper mineralization – potassic alteration with sheeted veins, Antay Project



OTHER PROJECTS

Yunnan Porphyry Project, China

The **Yunnan Porphyry Project** is located in the western portion of Yunnan Province and covers an area of approximately 62,000 square kilometres. The Project is a 50/50 Joint Venture with Newmont Overseas Exploration Limited and is targeting copper-gold porphyries and alkalic-related gold systems in the Tertiary Structural Belt of Western Yunnan. This Belt is known to host several copper-gold porphyries and mineralization hosted in Tertiary continental sediments.

Initial work on the Project has focused on regional BLEG (Bulk Leach Extractable Gold) stream sediment sampling to define areas of interest. Over 4,000 samples have been collected and about 70% of the program has been completed. Data analysis has



shown that the BLEG method is an important first phase tool to define areas of gold mineralization warranting follow-up work. The program has been successful in identifying several areas of interest and an extensive evaluation program will be initiated in the first quarter of 2006.

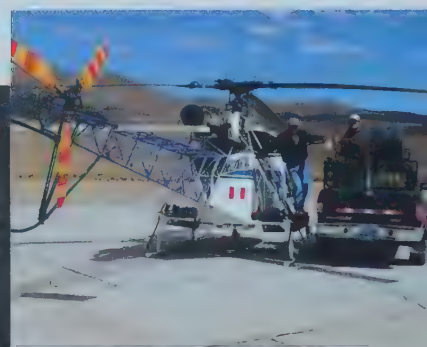
Millo-Azucar, Peru

The **Millo-Azucar Project** is a 50/50 Joint Venture between the Company and Meridian Gold Inc. and is located in the Puquio-Cailloma gold-silver metallogenic province within the Cordillera-Huanclo in the northern portion of the Company's Liam Joint Venture. The Project is comprised of approximately 6,700 hectares of exploration concessions located 570 kilometres southeast of Lima at altitudes between 4,600 and 5,200 metres.

Several important vein systems have been identified within the Joint Venture area, and exploration in 2005 has focused on the evaluation of their potential. Underlying the Azucar block, epithermal veins up to 2 metres in width and extending for up to

1,000 metres in strike length have returned high gold-silver assay values. The veins also contain appreciable concentrations of sulphides including chalcopyrite, galena, sphalerite, stibnite and sulfo salts of silver and native silver.

The Millo-Azucar Joint Venture represents an important target for bonanza-type gold-silver veins and an initial drilling program totalling 2,700 metres is planned for mid-2006 to test these mineralized structures.



Helicopter refuelling, Orcopampa airstrip

Pacapausa, Peru

The Pacapausa Silver-Gold Project is owned 100% by Southwestern subject to an option agreement with Oro Vega S.A. Pacapausa is comprised of 7,933 hectares of exploration concessions, and several types of silver-gold mineralization are being targeted.

The main focus of the exploration program is on the Cusana Zone, which is defined by an area of silification and argillic alteration extending for 6,000 metres along strike and between 500 metres and 1,500 metres wide. The silicified zone is expressed topographically as a narrow northeast-trending ridge underlain by swarms of mineralized veins. Most of the vein structures are 2 to 3 metres in width and commonly greater than one kilometre



in strike length. Oro Vega plans a comprehensive exploration program in 2006.

Reconnaissance exploration camp on the Accha-Yanque Project



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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

December 31, 2005 and 2004

This Management's Discussion and Analysis of Southwestern Resources Corp. (the "Company" or "Southwestern"), dated as at March 6, 2006, provides an analysis of Southwestern's financial results for the year ended December 31, 2005 compared to the previous year and should be read in conjunction with the Company's December 2005 audited consolidated financial statements and related notes which have been prepared in accordance with Canadian generally accepted accounting principles.

Southwestern is an exploration stage mineral exploration company engaged in the identification, acquisition, evaluation and exploration of mineral properties, especially with the potential to host gold, silver and base metals, and is currently active in China and Peru. The Company is a reporting issuer in British Columbia, Alberta, Manitoba and Ontario, and trades on the Toronto Stock Exchange under the symbol SWG.

The Company conducts its exploration independently as well as through joint venture agreements with third parties whereby a third party earns an interest in the Company's property by fulfilling terms as outlined in the agreement. The majority of joint venture agreements are structured in such a way as to allow an interested party to earn an interest in a project by making certain expenditures on the Company's properties over a period of time. The Company is also involved in exploration through option or earn-in agreements whereby it provides 100% of the funding in order to earn a controlling interest in a project owned by a third party.

PERFORMANCE

As at December 31, 2005, Southwestern had a solid balance sheet with working capital of \$62.0 million and no long term debt.

During 2005, the Company received aggregate net proceeds of \$30,267,000 pursuant to two separate private placements:

- i) A bought deal financing arrangement with a syndicate of underwriters of 2,450,000 common shares at \$10.80 per share, and
- ii) A non-brokered private placement by Newmont Mining Corporation of Canada Ltd. ("Newmont Canada") for 400,000 common shares at \$13.00 per share.

In December 2005, the Company also received final payment of US\$3.5 million from Compania de Minas Buenaventura S.A.A. ("Buenaventura"), relating to the sale of the Company's interest in the Poracota Property in Peru.

Approximately \$17.8 million was spent on exploration during the year, the majority of which related to drilling and associated costs at the Boka Gold Project.

CHINA

BOKA GOLD PROJECT

The Company's main project in China is the Boka Gold Project located in Yunnan Province about 265 kilometres by road north of the capital city of Kunming. The Boka Project is the subject of a Sino-Foreign Joint Venture contract between a Southwestern subsidiary and Team 209 of the Yunnan Nuclear Industry of Yunnan Province ("Team 209"). The Joint Venture Company (Yunnan Gold Mountain Mining Co. Ltd.) is owned 90% by Southwestern and 10% by Team 209. Southwestern is contributing 100% of the exploration funds with Team 209 retaining a 10% carried share holding in the Joint Venture Company, which has a 25 year business license. The Boka Project is comprised of three exploration concessions and three mining licenses covering 157 square kilometres. These concessions and licenses are registered in the name of the Joint Venture Company.

The Boka Project has been the subject of an intense drilling program focused mainly on the Boka 1 Gold Zone. To January 31, 2006, 156 holes had been completed totalling approximately 62,000 metres. The majority of this drilling has been carried out at Boka 1 mostly on a 50 metre by 50 metre spacing.

In 2005, Hatch Limited, an internationally recognized engineering firm, completed the Preliminary Assessment Report on the Boka Gold Project. The assessment was based on 67 drill holes and, in view of subsequent drill results not used in the report, it is management's belief that the mine plan set forth by Hatch may be conservative. Results from the Hatch Report concluded that the Company should immediately commence a pre-feasibility study on the Boka Gold Project and concluded positively on the scope for developing a mining operation with a capacity to support production levels of 200,000 ounces of gold per annum.

The Hatch Report also concluded that the Boka Gold Project contained an indicated resource of 10.45 million tonnes grading 2.88 grams per tonne gold equivalent to 966,000 ounces gold, and an inferred resource of 45.78 million tonnes grading 2.75 grams per tonne gold equivalent to 4,048,000 ounces gold. Furthermore, the Hatch Report concluded that these resources could support an open pit mining operation with estimated cash costs of US\$143 per ounce of gold. Capital costs for the mining operation were estimated at US\$174 million.

The Company awarded the preparation of a pre-feasibility study to Ausenco Limited, an internationally recognized, Australian-based firm that specializes in the provision of engineering construction and project management services to the mining and mineral processing industry, particularly in the Asian region. Ausenco was the lead engineering firm for the development of Sinogold's Jinfeng Mine, the largest foreign owned gold mine in China. Golder Associates Pty Ltd. and SRK Consulting have been contracted to work on areas such as environmental, tailings disposal, pit design and resource estimates.

YUNNAN PORPHYRY JOINT VENTURE

The Company, through a wholly owned subsidiary, and Newmont Overseas Exploration Limited are evaluating an area in western Yunnan of approximately 62,000 square kilometres on a 50/50 basis. Targets in the area include copper-gold porphyries and alkaline related gold systems. The Joint Venture has collected over 4,000 BLEG (bulk leach extractable gold) stream sediment samples as a first-pass evaluation. Several important anomalous gold areas have been identified and an aggressive follow-up program will commence in early 2006.

PERU

LIAM GOLD-SILVER PROJECT

The Liam Project is situated in the Department of Cuzco in the southern portion of the Peru Tertiary Volcanic Belt and located 170 kilometres northwest of Arequipa. The Project is a 50/50 Joint Venture with Newmont Peru Limited and is comprised of 367,000 hectares of exploration concessions. Southwestern is the manager of the Project. The Project area lies within the Peruvian Altiplano at an altitude of 4,470 metres to 5,370 metres. Liam is accessible by road from the mining community of Orcopampa, where an airstrip allows access by charter aircraft from Lima or Arequipa. It is a two hour drive by gravel road to the Liam Project from Orcopampa.

Exploration work conducted by the Joint Venture partners so far has identified nine gold-silver zones of various types hosted within Tertiary volcanics and Cretaceous sediments. Selected areas of mineralization are discussed below.

Cerro Crespo

Cerro Crespo outcrops as a prominent northwest-southeast trending ovoid shaped ridge with near vertical edges. The ridge is mainly comprised of hydrothermal and magmatic breccias containing vuggy silica and alunite with variable amounts of hematite/limonite. Higher grade gold and silver mineralization in drill holes at the Cerro Crespo Zone is associated with late fractures in the breccias and with intense limonite-hematite. Infill drilling is planned to be completed at Cerro Crespo in 2006.

Cerro Queshca

Cerro Queshca is located approximately 1 kilometre north of Cerro Crespo. Six zones of outcropping mineralization have been identified at Cerro Queshca and drilling has shown these zones to be possibly isolated remnants of an eroded larger system. In places, mineralization at Cerro Queshca is high grade and normally associated with intense silicification and late hematite filled fracturing.

Farallon

The Farallon Zone is located approximately 10 kilometres southwest of Cerro Crespo and is a large epithermal system of low sulphidation gold mineralization extending for 1,000 metres by 800 metres. The mineralized zone outcrops as a prominent ridge trending northwest-southeast and is covered by post mineralization volcanics to the north and east. Extensive rock chip sampling on one metre channels has shown that surface gold concentrations are generally in the 0.2 to 0.5 gram per tonne range with isolated areas of higher grade from 5 to 128 grams per tonne gold. A preliminary drilling program was completed at Farallon in late 2005 and results for the drilling are pending.

Astana

The Astana gold-silver zone is located approximately 1 kilometre west of Farallon and outcrops over an area of 400 metres by 200 metres. Gold-silver mineralization at Astana is high sulphidation in nature and associated with vuggy silica and alunite. Extensive rock chip sampling of the Astana Zone indicates surface values for gold ranging from 0.2 to 1.8 grams per tonne. Silver values in rock chip samples returned values of up to 450 grams per tonne. A first phase drill program was completed in late 2005 and results are pending.

Careli

The Careli Zone is located approximately 30 kilometres northeast of Cerro Crespo and outcrops poorly along a northwest-southeast trending prominent dome shaped ridge. Gold mineralization is associated with high sulphidation alteration in a zone 700 metres by 200 metres. Rock chip sampling of sporadic outcrop within this domal feature returned gold values ranging from 0.1 to 3.6 grams per tonne. A first phase drilling program is planned to commence in the second quarter of 2006.

Huacullo

The Huacullo Zone is located 20 kilometres northwest of Cerro Crespo and is underlain by Cretaceous sediments and Tertiary volcanics. Several types of mineralization occur at Huacullo including extensive hydrothermal breccia zones ranging in width from 0.5 metres to 6 metres and extending for up to 1,000 metres in length. The breccias are comprised of both Cretaceous sediment and Tertiary volcanic fragments in a silica matrix. Forty-two rock chip samples were collected across the breccia zone of which 11 samples report values ranging from 0.5 grams per tonne gold to 19 grams per tonne gold.

The No. 1 vein system at Huacullo extends discontinuously for 1,200 metres and ranges in width from 0.4 metres to 10 metres. The vein is comprised of white to grey banded quartz with grey coloured sulphides, in places of molybdenum and an unidentified silver mineral. A total of 46 rock chip samples were collected in the vein structure of which 26 reported values of 0.12 to 1.2 grams per tonne gold, 2.12 to 103 grams per tonne silver and 42 to 649 parts per million molybdenum. Further sampling and data evaluation will be completed prior to making a drilling decision.

ACCHA-YANQUE

The Accha-Yanque Zinc Project, located 120 kilometres south of Cuzco, is situated within a 35 kilometre long northeast-southwest trending belt of numerous oxide zinc occurrences located along the western margin of the Apurimac Batholith. Only the Accha Zone has seen extensive drilling, with preliminary drilling completed at Yanque, Capayoc and Azulcancha.

The Accha Zinc deposit, located in the northeast portion of this belt, is presently undergoing a pre-feasibility study including metallurgical reviews, geological modelling, resource calculations, environmental/social impact studies, logistics and mine planning. As part of the Accha pre-feasibility, drill programs will be conducted at Accha, Azulcancha, Capayoc, Yanque and Puyani to evaluate the combined resources of the belt into one mine plan. It is anticipated that the pre-feasibility study will be completed by the end of 2006.

ANTAY PROJECT

The Antay Copper-Molybdenum Porphyry Project, comprised of 50,000 hectares of exploration concessions, is situated within the Tintaya-Bambas Copper Gold Belt and is accessible by road from the city of Cuzco located about 150 kilometres northeast of the Project area. The Antay Project is 100% owned by Southwestern and is subject to a Joint Venture Agreement with Anglo American Exploration Peru S.A. ("Anglo"). Under the terms of the agreement, Anglo can earn up to 70% of the Project by completing a bankable feasibility study and subscribing for US\$5 million worth of Southwestern shares (57,848 shares worth US\$500,000 have been issued to date).

During 2005, Anglo focused exploration work in the southern portion of the Project area within the Ccora Sur Porphyry Zone. Anglo completed an extensive detailed mapping and sampling program plus an induced polarization geophysical survey. The Anglo work confirmed the presence of a large porphyry copper-molybdenum system associated with an induced polarization chargeability anomaly extending for 2.5 kilometres by 1.2 kilometres and a minimum 500 metre depth. A planned drilling program to initially test the Ccora Sur area is in the permitting stage and it is anticipated that drilling will commence in the second quarter of 2006.

RESULTS OF OPERATIONS

The consolidated net loss for the years ended December 31, 2005, 2004 and 2003 was \$9.5 million or \$0.22 per share, \$18.5 million or \$0.44 per share and \$8.0 million or \$0.23 per share respectively.

The decrease in 2005 arose mainly due to a decline in stock-based compensation totalling \$6.9 million and gains resulting from the partial sale of the Company's investment in FNX Mining Company Inc. ("FNX") as well as the sale of its interest in the Poracota Property in Peru. The increase in 2004 was the result of higher stock-based compensation expense recorded during the year.

The consolidated net loss for the fourth quarter of 2005 was \$779,000 or \$0.02 per share compared with a net loss of \$1,238,000 or \$0.02 per share for the same period in 2004. The decrease was the result of a gain on disposition of FNX shares

(\$441,000) in October 2005 as well as a gain arising from the sale of the Company's 50% interest in the Poracota Property (\$640,000). These gains were partially offset by higher consulting fees in comparison to those recorded during the fourth quarter ended December 31, 2004.

A total of 1,309,500 stock options were granted in 2005 that resulted in stock-based compensation expense totalling \$5.4 million compared to 1,793,000 stock options granted in 2004 resulting in compensation expense of \$12.4 million and 182,000 options granted in 2003 resulting in stock-based compensation expense of \$728,000. Only 1,042,500 stock options granted in 2005 have vested. The lower number of options vesting and a lower weighted-average grant date fair value in 2005 compared to 2004 are the main reasons for the decrease in stock-based compensation expense.

Overall general and administrative expenses increased to \$3.8 million in 2005 compared with \$3.2 million in 2004 and \$2.4 million in 2003. The increase was mainly due to higher consulting fees (increase of \$477,000) and salaries and benefits (increase of \$156,000). Additional consultants were retained for corporate services and existing consultants charged greater fees for corporate related matters. Salaries and benefits increased due to the expansion of staff resources in all areas of the Company required to meet the needs created by increased business activity. Other general and administrative expenses such as shareholder information, office, legal and accounting, and travel remained fairly constant in comparison to the previous years.

Foreign exchange gains and losses result primarily from the translation of US dollar denominated monetary assets to Canadian dollars. The higher foreign exchange losses recorded resulted from the strengthening of the Canadian dollar during the year.

General exploration expense relates to expenditures of a generative nature along with some of the costs of maintaining the Company's foreign exploration offices. General exploration expense was higher in 2005 due to increased general reconnaissance work being conducted in China and Peru.

The Company wrote off \$698,000 in resource property costs, of which \$452,000 pertained to the Sichuan Project in China. The Sichuan Project was generated in early 2003 based on a letter agreement between the Company and Chengdu Institute of Environmental Geology and Mineral Resources Development. The remaining balance written off related to various non-core projects in Peru. In 2004, the Company wrote off expenditures totalling \$3,193,000 mainly comprised of the Tecka Project in Argentina (\$1,688,000) and the Puno Project in Peru (\$561,000) as well as other non-core projects in Peru. In 2003, the Company wrote off expenditures totalling \$1,906,000 comprised of properties in Peru.

Interest and other income is comprised of interest revenue and management fees charged to affiliated companies and was higher in 2005 and 2004 due to a larger treasury.

During 2005, the Company recorded a loss of \$218,000 as its equity in the operations of affiliated companies compared with a gain of \$458,000 during 2004 and a loss of \$1,280,000 during 2003. The current year loss relates to the Company's share of losses recorded by Superior Diamonds Inc. ("Superior") (\$191,000) and Aurora Platinum Corp. ("Aurora") (\$27,000). The variance between 2005 and 2004 is due to Aurora recording a profit in 2004 that resulted in Southwestern recording a gain of \$597,000. The loss in 2003 was the result of a write off of foreign assets of an affiliated company.

In June 2005, all of the issued and outstanding shares of Aurora were acquired by FNX. As a result Southwestern received 644,133 shares of FNX. In late 2005, Southwestern sold 224,626 FNX shares and realized a gain of \$1,018,480.

In 2002, the Company signed an agreement with Buenaventura to sell its 50% interest in the Poracota Property in Peru for US\$4.5 million. Under the terms of the agreement, Buenaventura made payments to Southwestern of US\$100,000 in 2002, US\$200,000 in 2003, US\$300,000 in February 2005 and made the final payment of US\$3,900,000 in December 2005 to complete the transaction, resulting in a gain of \$640,000.

Dilution gains of \$414,000 (2004 – \$537,000; 2003 – \$174,000) were recorded as a result of equity financings completed by Superior and Aurora during these years.

Gains or losses on shares issued by affiliated companies arise when the ownership interest of the Company in a significantly influenced or controlled company is diluted as a result of share issuances of the investee company. The Company does not receive any cash proceeds (nor is it required to make any payments) for such transactions.

Equity in operations of affiliated companies represents the Company's share of the net gains or losses for the reporting period in a significantly influenced company.

ANNUAL FINANCIAL INFORMATION

The following selected consolidated financial data has been prepared in accordance with Canadian generally accepted accounting principles and should be read in conjunction with the Company's audited consolidated financial statements. All dollar amounts are in Canadian dollars.

<i>For the years ended December 31</i>	2005	2004	2003
<i>(C\$ in thousands except per share amounts)</i>			
FINANCIAL RESULTS			
INTEREST AND OTHER INCOME	1,346	1,127	445
NET LOSS	(9,540)	(18,525)	(8,049)
LOSS PER SHARE*	(0.22)	(0.44)	(0.23)
FINANCIAL POSITION			
WORKING CAPITAL	62,024	48,260	23,414
MINERAL PROPERTIES	34,879	23,587	15,526
TOTAL ASSETS	108,174	82,179	45,264
SHARE CAPITAL	178,923	149,476	107,635
DEFICIT	(93,340)	(83,800)	(65,275)
NUMBER OF COMMON SHARES ISSUED AND OUTSTANDING	45,934	42,786	39,122

QUARTERLY FINANCIAL INFORMATION

<i>2005 fiscal quarter ended</i>	4th Quarter December 31, 2005	3rd Quarter September 30, 2005	2nd Quarter June 30, 2005	1st Quarter March 31, 2005
<i>(C\$ in thousands except per share amounts)</i>				
INTEREST AND OTHER INCOME	460	289	292	305
NET LOSS	(779)	(2,081)	(4,348)	(2,332)
LOSS PER SHARE*	(0.02)	(0.05)	(0.10)	(0.05)
<i>2004 fiscal quarter ended</i>	4th Quarter December 31, 2004	3rd Quarter September 30, 2004	2nd Quarter June 30, 2004	1st Quarter March 31, 2004
INTEREST AND OTHER INCOME	342	311	280	194
NET LOSS	(1,238)	(1,375)	(4,085)	(11,827)
LOSS PER SHARE*	(0.02)	(0.02)	(0.10)	(0.30)

*Loss per share is calculated based on the weighted-average number of shares outstanding.

An analysis of the quarterly results over the last eight quarters shows a significant variation between the first quarter of 2005 and 2004. This was due to a reduced amount of stock-based compensation expense recorded in March 2005. The variation in the quarters ended September 30 is comprised of higher general and administrative expenses and foreign exchange losses whereas the variation between the fourth quarters is due to a gain in disposition of mineral properties. The large increase in net loss from the first quarter to the second quarter of 2005 was the result of stock option grants and the related stock-based compensation expense.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

The Company is not in commercial production on any of its mineral properties and, accordingly, it does not generate cash from operations. The Company finances its activities by raising capital through the equity markets. The Company is in excellent financial condition with no long-term debt and working capital as at December 31, 2005 of \$62.0 million.

The Company expended \$5.2 million on net operating activities during the year ended December 31, 2005 compared with \$4.0 million in 2004 and \$4.3 million in 2003. The increase in 2005 relates to higher general and administrative and general reconnaissance costs as well as foreign exchange losses.

The Company expended \$9.5 million on investing activities during 2005 compared with \$12.3 million in 2004 and \$5.0 million in 2003. During 2005, the Company expended \$10.4 million on mineral property and related deferred costs in China and Peru. The majority of the expenditures were incurred on the extensive drilling program at the Boka Project in China. The Company also completed a Preliminary Assessment Report, which recommended the preparation of the full pre-feasibility study commenced in 2005. A total of \$1.9 million was expended on acquisition of shares in Superior (\$400,000) and Lake Shore Gold Corp. ("Lake Shore") (\$1.5 million) and a further \$200,000 on capital assets. The Company also received proceeds of approximately \$3.0 million from the sale of FNX shares. In 2004, the primary focus of mineral property expenditures was also on the Boka Project and, to a lesser degree, the Liam and Antay projects in Peru, and a net \$1.4 million was expended on the acquisition/disposition of investments. In 2003, \$4.9 million was expended on mineral properties in China and Peru.

The carrying value of resource properties increased by \$11.3 million as a result of exploration expenditures of \$17.8 million which were offset by \$698,000 in resource property write offs and US\$3.8 million received from Buenaventura pursuant to the Poracota option agreement and a further \$1.3 million in cost recovery recorded as a result of the private placement with Newmont Canada which was purchased at a premium. A total of \$14.0 million was spent in China of which \$13.4 million relates to the Boka Gold Project, and another \$3.8 million on projects in Peru.

The Company generated net proceeds from financing activities of \$29.4 million in 2005, \$41.8 million in 2004 and \$28 million in 2003. The majority of the proceeds arose from private placement share issuances as noted below:

i) In July 2005, the Company received net proceeds of \$608,346 by issuing 57,848 common shares pursuant to the Antay Property option agreement.

ii) In October 2005, Newmont Canada purchased 400,000 common shares of Southwestern at a price of \$13.00 per share for proceeds of \$5.2 million. The price, at a premium of \$3.33 per share to the market price, resulted in \$1,332,000 of the gross proceeds being recorded as a reduction to mineral properties rather than an increase in share capital.

iii) Also in October 2005, the Company received net proceeds of \$24.9 million by issuing 2,450,000 common shares to a syndicate of underwriters at a price of \$10.80 per share.

Share issue costs for financings completed in 2005 totalled \$1,592,842.

In May 2005, the Company received regulatory approval of its "Notice of Intention To Make a Normal Course Issuer Bid." The Company has the option to acquire up to 2 million of its own common shares until May 26, 2006. During 2005, the Company purchased 80,000 shares for total consideration of \$778,144.

In September 2005, the Company purchased 2 million common shares of Lake Shore at a net cost of \$1,515,000. In April 2005, the Company also purchased an additional 888,889 common shares of Superior at a cost of \$400,000. As at December 31, 2005, the Company's investments had a carrying value of \$8,084,000 (2004 – \$8,027,000) and a market value of \$16,390,000 (2004 – \$9,089,000)

The Company has commitments totalling \$1,725,917 over five years (2006 to 2009 – \$363,351 per year; 2010 – \$272,513) pertaining to its leasehold obligations. With respect to other contractual obligations, there are no material changes during the current period that are outside the ordinary course of the Company's business.

OUTSTANDING SHARE CAPITAL

As at March 6, 2006, there were 46,239,522 common shares issued and 46,159,522 common shares outstanding and the following options:

Exercise Price Range	Number of Options Outstanding (000's)
\$1.46-\$10.00	583
\$10.40-\$13.60	1,242
\$14.95-\$18.38	1,634
	<u>3,459</u>

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Acquisition costs of mineral properties together with direct exploration and development expenditures are capitalized. When production is attained, these costs will be amortized. When capitalized expenditures on individual properties exceed the estimated net realizable value, the properties are written down to the estimated value. Costs relating to properties abandoned are written off when the decision to abandon is made.

Investments in corporations in which the Company exercises significant influence are accounted for using the equity method, whereby the investment is initially recorded at cost and is adjusted to recognize the Company's share of earnings or losses and reduced by dividends and distributions received. Other investments are accounted for using the cost method. Impairments in value, other than those that are temporary in nature, are recorded as a charge to operations.

The Company's financial assets and liabilities are cash and cash equivalents, exploration advances and other receivables, a note receivable, investments and accounts payable and accrued charges. The fair values of these financial instruments are estimated to be their carrying values due to their short-term or demand nature. Cash and cash equivalents includes those short-term money market instruments which, on acquisition, have a term to maturity of three months or less and expose the Company to minimal risk.

CICA Handbook section 3870, "Stock-Based Compensation and Other Stock-Based Payments" establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. Compensation expense is determined using the Black-Scholes option pricing model based on estimated fair values of all stock-based awards at the date of grant and is expensed to operations over each award's vesting period.

The Black-Scholes option pricing model utilizes subjective assumptions such as expected price volatility and expected life of the option. Changes in these input assumptions can significantly affect the fair value estimate.

For the year ended December 31, 2005, total stock-based compensation expense of \$5,435,000 (2004 – \$12,377,000; 2003 – \$728,000) was calculated using the following assumptions: no dividends are to be paid; expected volatility of 58% (2004 – 47%; 2003 – 96%); risk-free interest rate of 3.5% (2004 – 5%; 2003 – 5%) and expected life of 3.5 years (2004 – 3.5 years; 2003 – 5 years). An equivalent amount is included in contributed surplus.

RELATED PARTY TRANSACTIONS

During the year ended December 31, 2005, the Company paid remuneration to directors and to companies controlled by officers who are also directors in the amount of \$514,750 (2004 – \$808,781; 2003 – \$520,573). The Company received management fees totalling \$117,000 (2004 – \$192,000; 2003 – \$240,000) from Aurora (\$6,000 per month), Superior (\$3,000 per month) and Lake Shore (\$3,000 per month). These are companies related by way of common directors. Aurora ceased to be a related party effective July 1, 2005 as a result of its acquisition by FNX.

There was also \$6,194 (2004 – \$17,006) due to Southwestern from the aforementioned companies at December 31, 2005.

CORPORATE GOVERNANCE

The Company's Board of Directors follows recommended corporate governance guidelines for public companies to ensure transparency and accountability to shareholders.

The current Board of Directors is comprised of five individuals, three of whom are neither officers nor employees of the Company and are unrelated in that they are independent of management. The Audit Committee is comprised of three directors who are independent of management. Two of the three Audit Committee members are professional accountants.

The Audit Committee fulfills its role of ensuring the integrity of the reported information through its review of the interim and audited annual financial statements prior to their submission to the Board of Directors for approval. The Audit Committee meets with management quarterly to review the financial statements including the MD&A and to discuss other financial, operating and internal control matters. The Company also has the practice of engaging its external auditors to perform quarterly reviews of its interim financial statements.

Management is responsible for the preparation and integrity of the financial statements and maintains appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete and reliable. The Company has also undertaken the task of evaluating the internal controls and disclosure controls in order to comply with certification requirements of sections 404 and 302 of the Sarbanes-Oxley Act.

RISKS AND UNCERTAINTIES

The business of mineral deposit exploration and extraction involves a high degree of risk. Few properties that are explored are ultimately developed. At present, none of the Company's properties has a known body of commercial ore. Other risks facing the Company include share price volatility, uncertainty of additional financing, competition, title risks, political, environmental and insurance risks, fluctuations in mineral prices and foreign currencies, risks relating to statutory and regulatory compliance as well as political and economic uncertainty in developing countries. The specifics of the Company's risks are detailed in disclosures with the heading "Risk Factors" in the Company's periodic filings with securities regulators.

OUTLOOK

The Company's business philosophy has been to focus exploration efforts on areas with world class potential, and to leverage management's knowledge and technical expertise through joint venture agreements with major mining companies. Southwestern has been able to lead the way in developing highly prospective exploration projects in emerging countries. The Company will continue to focus the majority of its exploration activities in China and Peru and to seek opportunities to form additional joint ventures in order to reduce shareholder risk. With its current treasury, the Company is also in an advantageous position to seek new opportunities.

Over the course of the past twelve years as a publicly listed company, Southwestern has been very successful in its ability to raise equity capital. However, as a mineral exploration company, the future liquidity of Southwestern will be affected by its ability to raise capital as required. In management's view, the Company's cash position is more than sufficient to complete the two pre-feasibility studies initiated in China (Boka) and Peru (Accha), to fund planned exploration programs and for project generation.

ADDITIONAL INFORMATION

Additional information is provided in the Company's audited consolidated financial statements for the year ended December 31, 2005 and the Company's Annual Information Form and Information Circular. These documents are available on SEDAR at www.sedar.com.

REPORT OF INDEPENDENT REGISTERED CHARTERED ACCOUNTANTS

SHAREHOLDERS OF SOUTHWESTERN RESOURCES CORP.

We have audited the consolidated balance sheets of Southwestern Resources Corp. as at December 31, 2005 and 2004 and the consolidated statements of loss and deficit, shareholders' equity and cash flows for each of the years in the three year period ended December 31, 2005, and for the period from inception to December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. These standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2005 and for the period from inception to December 31, 2005 in accordance with Canadian generally accepted accounting principles.

The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion.



INDEPENDENT REGISTERED CHARTERED ACCOUNTANTS

VANCOUVER, BRITISH COLUMBIA

March 6, 2006

CONSOLIDATED BALANCE SHEETS

AN EXPLORATION STAGE COMPANY

As at December 31 (C\$ in thousands)

	2005	2004
ASSETS		
CURRENT		
CASH AND CASH EQUIVALENTS (note 3)	\$ 63,809	\$ 49,119
EXPLORATION ADVANCES AND OTHER RECEIVABLES	691	764
	64,500	49,883
PROPERTY, PLANT AND EQUIPMENT (note 4)	711	682
MINERAL PROPERTIES (note 5)	34,879	23,587
INVESTMENTS (note 6)	8,084	8,027
	\$ 108,174	\$ 82,179
LIABILITIES		
CURRENT		
ACCOUNTS PAYABLE	\$ 169	\$ 50
ACCRUED CHARGES	2,307	1,573
	2,476	1,623
COMMITMENTS (note 13)		
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (note 8)		
AUTHORIZED		
UNLIMITED		
ISSUED		
45,934,000 SHARES (2004 – 42,786,000)	178,923	149,476
CONTRIBUTED SURPLUS	20,115	14,880
DEFICIT	(93,340)	(83,800)
	105,698	80,556
	\$ 108,174	\$ 82,179

See accompanying notes to consolidated financial statements

APPROVED BY THE BOARD



JOHN G. PATERSON



JAMES B. HUME

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

AN EXPLORATION STAGE COMPANY

For the years ended December 31	Cumulative from inception to December 31 2005	2005	2004	2003
(C\$ in thousands except per share amounts)				
EXPENSES				
GENERAL AND ADMINISTRATIVE (note 11)	\$ 31,332	\$ 3,841	\$ 3,177	\$ 2,420
GENERAL EXPLORATION	14,445	2,168	1,648	1,345
MINERAL PROPERTY COSTS WRITTEN OFF (note 5)	37,383	698	3,193	1,906
FOREIGN EXCHANGE (GAIN) LOSS	(1,504)	566	324	987
AMORTIZATION	840	37	36	42
LOSS BEFORE UNDERNOTED ITEMS	(82,496)	(7,310)	(8,378)	(6,700)
INTEREST AND OTHER INCOME	15,089	1,346	1,127	445
GAIN ON SHARES ISSUED BY				
AFFILIATED COMPANIES (note 6)	5,597	414	537	174
GAIN ON SALE OF INVESTMENTS (note 6)	1,166	1,018	108	40
(LOSS) GAIN ON DISPOSITION OF PROPERTY, PLANT AND EQUIPMENT	(110)	5	–	–
WRITE DOWN OF INVESTMENTS	(4,596)	–	–	–
GAIN ON DISPOSITION OF MINERAL PROPERTIES (note 5)	640	640	–	–
EQUITY IN OPERATIONS OF AFFILIATED COMPANIES (note 6)	(6,872)	(218)	458	(1,280)
STOCK-BASED COMPENSATION (note 8)	(19,025)	(5,435)	(12,377)	(728)
NET LOSS FOR THE YEAR	(90,607)	(9,540)	(18,525)	(8,049)
DEFICIT AT BEGINNING OF YEAR	–	(83,800)	(65,275)	(57,226)
LOSS ON SALE OF OWN SHARES	(2,733)	–	–	–
DEFICIT AT END OF YEAR	\$ (93,340)	\$ (93,340)	\$ (83,800)	\$ (65,275)
LOSS PER SHARE – BASIC AND DILUTED		\$ (0.22)	\$ (0.44)	\$ (0.23)
WEIGHTED-AVERAGE NUMBER OF SHARES OUTSTANDING		43,633	41,816	35,422

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

AN EXPLORATION STAGE COMPANY

	Cumulative from inception to December 31 2005	2005	2004	2003
<i>For the years ended December 31</i>				
<i>(C\$ in thousands)</i>				
OPERATING ACTIVITIES				
NET LOSS FOR THE YEAR	\$ (90,607)	\$ (9,540)	\$ (18,525)	\$ (8,049)
ITEMS NOT INVOLVING CASH				
AMORTIZATION	840	37	36	42
MINERAL PROPERTY COSTS WRITTEN OFF	37,383	698	3,193	1,906
GAIN ON SHARES ISSUED BY				
AFFILIATED COMPANIES	(5,597)	(414)	(537)	(174)
GAIN ON SALE OF INVESTMENTS	(1,191)	(1,018)	(108)	(40)
LOSS (GAIN) ON DISPOSITION OF PROPERTY				
PLANT AND EQUIPMENT	110	(5)	—	—
WRITE DOWN OF INVESTMENTS	4,596	—	—	—
GAIN ON DISPOSITION OF				
MINERAL PROPERTIES	(640)	(640)	—	—
EQUITY IN OPERATIONS OF				
AFFILIATED COMPANIES	6,872	218	(458)	1,280
STOCK-BASED COMPENSATION	19,025	5,435	12,377	728
	(29,209)	(5,229)	(4,022)	(4,307)
CHANGE IN NON-CASH OPERATING				
WORKING CAPITAL ITEMS				
(INCREASE) DECREASE IN EXPLORATION				
ADVANCES AND OTHER RECEIVABLES	(392)	62	(68)	(34)
INCREASE IN ACCOUNTS PAYABLE				
AND ACCRUED CHARGES	379	13	131	19
CASH USED IN OPERATING ACTIVITIES	(29,222)	(5,154)	(3,959)	(4,322)
INVESTING ACTIVITIES				
ACQUISITION OF INVESTMENTS	(11,381)	(1,915)	(1,502)	—
DISPOSITION OF INVESTMENTS	3,090	2,970	149	—
DECREASE IN CASH DUE TO CHANGE IN				
ACCOUNTING FOR INVESTMENT IN				
CANABRAVA DIAMOND CORPORATION	(3,356)	—	—	—
MINERAL PROPERTY EXPENDITURES	(83,850)	(14,898)	(10,469)	(4,912)
DISPOSITION OF MINERAL PROPERTY	4,539	4,539	—	—
ADDITIONS TO PROPERTY, PLANT				
AND EQUIPMENT	(3,443)	(203)	(480)	(78)
CASH USED IN INVESTING ACTIVITIES	(94,401)	(9,507)	(12,302)	(4,990)
FINANCING ACTIVITIES				
SHARES ISSUED	182,827	30,129	41,841	28,050
SHARES PURCHASED	(14,214)	(778)	—	—
SHARES RESOLD	8,694	—	—	—
NON-CONTROLLING INTEREST	10,325	—	—	—
NOTE RECEIVABLE	(200)	—	—	—
CASH PROVIDED BY FINANCING ACTIVITIES	187,432	29,351	41,841	28,050
INCREASE IN CASH AND CASH				
EQUIVALENTS DURING THE YEAR	63,809	14,690	25,580	18,738
CASH AND CASH EQUIVALENTS				
BEGINNING OF YEAR	—	49,119	23,539	4,801
CASH AND CASH EQUIVALENTS END OF YEAR	\$ 63,809	\$ 63,809	\$ 49,119	\$ 23,539
CASH AND CASH EQUIVALENTS CONSIST OF:				
CASH		\$ 60,963	\$ 48,211	\$ 1,408
SHORT-TERM INVESTMENTS		2,846	908	22,131
		\$ 63,809	\$ 49,119	\$ 23,539

SUPPLEMENTAL CASH FLOW INFORMATION (note 12)

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004

(All tabular amounts are in thousands of dollars)

DESCRIPTION OF BUSINESS

Southwestern Resources Corp. ("Southwestern" or the "Company") is an exploration stage junior mining company engaged in the identification, acquisition, evaluation, exploration and development of mineral properties, especially those with the potential to host gold, silver and base metals, primarily in Peru and China. Operations are conducted either directly or through agreements with third parties. The Company has not determined whether these properties contain mineral reserves which are economically recoverable. The recoverability of amounts capitalized as mineral properties is dependent upon the discovery of economically recoverable reserves, and the ability of the Company to obtain necessary financing to complete the development and attainment of future profitable production from the properties or proceeds from disposition.

SIGNIFICANT ACCOUNTING POLICIES

A) BASIS OF PRESENTATION

The consolidated financial statements are prepared based upon Canadian generally accepted accounting principles. Information with respect to generally accepted accounting principles in the United States is provided in Note 14.

The financial statements of entities which are controlled by the Company through voting equity interests, referred to as subsidiaries, are consolidated. Entities which are jointly controlled, referred to as joint ventures, are proportionately consolidated. Variable Interest Entities ("VIEs"), which include, but are not limited to, special purpose entities, trusts, partnerships and other legal structures, as defined by the Accounting Standards Board in Accounting Guideline ("AcG") 15, "Consolidation of Variable Interest Entities" ("AcG 15"), are entities in which equity investors do not have the characteristics of a "controlling financial interest" or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are subject to consolidation by the primary beneficiary who will absorb the majority of the entities' expected losses and/or expected residual returns. Through this process the Company did not identify any less than 50% VIEs that required consolidation. All intercompany balances and transactions have been eliminated upon consolidation.

B) CASH AND CASH EQUIVALENTS

Cash and cash equivalents includes those short-term money market instruments which, on acquisition, have a term to maturity of three months or less.

C) INVESTMENTS

Investments in corporations in which the Company exercises significant influence are accounted for using the equity method, whereby the investment is initially recorded at cost and is adjusted to recognize the Company's share of earnings or losses and reduced by dividends and distributions received. Other investments are accounted for using the cost method. Impairments in value, other than those that are temporary in nature, are recorded as a charge to operations.

D) FINANCIAL INSTRUMENTS

The Company's financial assets and liabilities are cash and cash equivalents, exploration advances and other receivables, note receivable, investments and accounts payable and accrued charges. The fair values of these financial instruments are estimated to be their carrying values due to their short-term or demand nature except for investments whose fair value is disclosed in note 6.

E) MINERAL PROPERTIES

Acquisition costs of mineral properties together with direct exploration and development expenditures thereon are capitalized. When production is attained these costs will be amortized. When capitalized expenditures on individual mineral properties exceed the estimated net realizable value, the properties are written down to the estimated value. Costs relating to properties abandoned are written off when the decision to abandon is made.

Expenditures of a general reconnaissance nature along with some of the costs of maintaining foreign exploration offices are written off to general exploration during the year.

F) JOINT VENTURES

The Company holds a significant portion of its interests in mineral properties through joint venture agreements. Currently the Company does not conduct its operating activities through these joint venture arrangements.

G) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is recorded at cost. Amortization is computed using the declining-balance method based on annual rates as follows:

OFFICE AND OTHER EQUIPMENT	20%
COMPUTER EQUIPMENT	30%
LEASEHOLD IMPROVEMENTS	STRAIGHT-LINE OVER 6 YEARS
VEHICLES	30%

H) FOREIGN CURRENCY TRANSACTION

All foreign currencies are translated into Canadian dollars using weighted-average rates for the year for items included in the consolidated statements of loss and deficit, the rate in effect at the balance sheet date for monetary assets and liabilities, and historical rates for other assets included in the consolidated balance sheets. Translation gains or losses are included in the determination of income.

I) FUTURE INCOME TAXES

The Company accounts for income taxes using the asset and liability method. Under this method, future income taxes are recorded for the temporary differences between the financial reporting basis and tax basis of the Company's assets and liabilities. These future taxes are measured by the provisions of currently substantively enacted tax laws. Management believes that it is not sufficiently likely that the Company will generate sufficient taxable income to allow the realization of future tax assets and therefore the Company has fully provided for these assets.

J) MEASUREMENT UNCERTAINTY

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates where management's judgment is applied include asset valuations, income taxes, contingent liabilities and stock-based compensation. Actual results may differ from those estimates.

K) STOCK OPTIONS

The fair value of all stock-based awards is estimated using the Black-Scholes model at the date of grant and is expensed to operations over each award's vesting period.

L) EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is computed by dividing net income or loss (the numerator) by the weighted-average number of outstanding common shares for the period (the denominator). In computing diluted earnings per share, an adjustment is made for the dilutive effect of the exercise of stock options and warrants using the treasury stock method. In all periods presented, fully diluted loss per share is not presented, as it is anti-dilutive.

M) PRIOR YEAR'S COMPARATIVES

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents of \$63.8 million (2004 – \$49.1 million) consist of cash and highly liquid money market instruments with credit ratings which expose the Company to minimal credit risk.

4. PROPERTY, PLANT AND EQUIPMENT

As at December 31

	Cost	Accumulated Amortization	2005 Net Book Value
OFFICE AND OTHER EQUIPMENT	\$ 768	\$ 575	\$ 193
COMPUTER EQUIPMENT	866	647	219
VEHICLES	922	623	299
	<u>\$ 2,556</u>	<u>\$ 1,845</u>	<u>\$ 711</u>

As at December 31

	2004		
	Cost	Accumulated Amortization	Net Book Value
OFFICE AND OTHER EQUIPMENT	\$ 693	\$ 543	\$ 150
COMPUTER EQUIPMENT	771	604	167
VEHICLES	892	527	365
	<u>\$ 2,356</u>	<u>\$ 1,674</u>	<u>\$ 682</u>

Amortization relating to exploration related assets has been allocated to mineral properties in the amount of \$141,309 (2004 – \$153,823).

MINERAL PROPERTIES

A)	December 31 2005	December 31 2004
CHINA		
BOKA	\$ 25,596	\$12,219
YUNNAN PORPHYRY	655	178
OTHER	539	407
TOTAL CHINA	<u>26,790</u>	<u>12,804</u>
PERU		
LIAM GOLD-SILVER	3,194	3,501
PORACOTA	–	4,265
BAMBAS WEST	715	690
BAMBAS NORTH	623	353
ANTAY	748	660
MINASPATA	438	–
OTHER	2,371	1,314
TOTAL PERU	<u>8,089</u>	<u>10,783</u>
TOTAL	<u>\$ 34,879</u>	<u>\$23,587</u>

B) For the year ended December 31, 2005, the significant expenditures were as follows:

	Boka	Liam Gold-Silver	Yunnan Porphyry	Other	Total
BALANCE, BEGINNING OF YEAR	\$ 12,219	\$ 3,501	\$ 178	\$ 7,689	\$ 23,587
PROPERTY ACQUISITION AND MAINTENANCE	63	443	–	179	685
ANALYTICAL	550	45	14	191	800
GEOPHYSICS	302	2	–	21	325
GEOLOGY	1,933	483	460	932	3,808
DRILLING	9,942	(8)	–	478	10,412
RESEARCH	35	30	–	287	352
PROJECT ADMINISTRATION	552	30	3	894	1,479
COST RECOVERY	–	(1,332)	–	–	(1,332)
SALE OF INTEREST	–	–	–	(4,539)	(4,539)
PROPERTY COSTS WRITTEN OFF	–	–	–	(698)	(698)
BALANCE, END OF YEAR	<u>\$ 25,596</u>	<u>\$ 3,194</u>	<u>\$ 655</u>	<u>\$ 5,434</u>	<u>\$ 34,879</u>

For the year ended December 31, 2004, the significant expenditures were as follows:

	Boka	Antay	Liam Gold-Silver	Other	Total
BALANCE, BEGINNING OF YEAR	\$ 3,760	\$ –	\$ 2,566	\$ 9,200	\$ 15,526
PROPERTY ACQUISITION AND MAINTENANCE	2,463	241	550	173	3,427
ANALYTICAL	320	35	15	33	403
GEOPHYSICS	17	48	–	30	95
GEOLOGY	1,183	242	268	615	2,308
DRILLING	4,192	–	–	52	4,244
RESEARCH	51	42	41	119	253
PROJECT ADMINISTRATION	233	52	61	178	524
PROPERTY COSTS WRITTEN OFF	–	–	–	(3,193)	(3,193)
BALANCE, END OF YEAR	\$ 12,219	\$ 660	\$ 3,501	\$ 7,207	\$ 23,587

c) The Company conducts its exploration independently as well as through joint venture agreements with third parties whereby a third party earns an interest in the Company's property by fulfilling terms as outlined in the agreement. The majority of joint venture agreements are structured in such a way as to allow an interested party to earn an interest in a project by making certain expenditures on the Company's properties over a period of time. The Company is also involved in exploration through option or earn-in agreements whereby it provides 100% of the funding in order to earn a controlling interest in a project owned by a third party.

CHINA

In November 2002, Canadian Southwest Gold Inc. ("CSG"), a wholly owned subsidiary of the Company, signed a joint venture agreement (the "JV Agreement") with Team 209 of the Nuclear Industry of Yunnan Province, China ("Team 209") regarding the Boka Gold Project. Team 209 and CSG established a joint venture company (the "JV Company") to hold and operate the Boka Gold Project. As at December 31, 2005, CSG had earned a 90% interest in the JV Company by contributing to that company US\$4,010,000 and making a payment of US\$1.7 million to Team 209. Team 209 retains a 10% carried interest and CSG is the operator of the Project.

In December 2004, the Company entered into an agreement with Newmont to jointly explore an area of approximately 76,000 square kilometres in Yunnan and Sichuan provinces, China. Both Southwestern and Newmont have a 50% interest in the Yunnan Porphyry Project and are funding exploration on a pro rata basis.

During 2005, the Company wrote off \$452,000 in exploration costs relating to the Sichuan Project in China.

PERU

In October 2005, the option agreement with Newmont Peru Limited ("Newmont"), covering the Liam Core Area, was terminated and the area covered by that agreement was amalgamated into an amended Liam Regional Venture Agreement governing what is now referred to as the Liam Gold-Silver Project. Under the terms of the amended Liam Regional Venture Agreement, both Newmont and Southwestern each have a 50% working interest and will each contribute 50% of the exploration funding. Newmont can earn a 70% interest in those portions of the Project that it advances to a bankable feasibility study by funding 100% of the costs to place those deposits into commercial production. In a separate transaction, details of which are discussed in note 8, Newmont purchased 400,000 common shares of Southwestern by paying a premium of \$3.33 per share totalling \$1,332,000. This amount is classified as "cost recovery" and recorded as a reduction in mineral properties.

In 2002, the Company signed an agreement with Compania de Minas Buenaventura S.A.A. ("Buenaventura") to sell Southwestern's 50% interest in the Poracota Property in Peru for US\$4.5 million. The final payment of US\$3.9 million was received in December 2005 and resulted in the recording of a gain of \$640,000.

During the year ended December 31, 2005, expenditures totalling \$246,000 were written off relating to various non-core projects in Peru. Expenditures written off during 2004 relating to miscellaneous projects in Peru, including the Puno Project (\$561,000), amounted to \$1,505,000.

In 2005, a subsidiary of the Company entered into a Heads of Agreement with Anglo American Exploration Peru S.A. ("Anglo") under which Anglo can earn a 55% interest in the Antay Project by spending US\$5 million in exploration over a five year period.

Once vested, Anglo will have the option to earn an additional 15% interest in the Project by producing, within the next five years, a bankable feasibility study on any specific target identified during the first option period. Anglo has a firm commitment to spend US\$750,000 on exploration in the initial two years of the first option. To maintain the first option during the last three years, Anglo must spend annually a minimum of US\$750,000 in exploration expenditures.

In a separate transaction, Anglo American BV ("Anglo BV") agreed to acquire the equivalent of US\$5 million of Southwestern shares over a five year period. During 2005, Anglo BV purchased 57,848 common shares of Southwestern for gross proceeds of US\$500,000 and has a firm commitment to purchase the equivalent of an additional US\$500,000 of Southwestern common shares within the next year. Anglo BV has the right to elect not to subscribe with respect to the remaining US\$4 million equivalent of Southwestern common shares.

In 2004, the Company wrote off all expenditures (\$1,688,000) relating to the Tecka Project in Argentina.

6. INVESTMENTS

A)

		December 31 2005	
	Ownership %	Carrying Value	Quoted Market Value
SIGNIFICANTLY INFLUENCED AFFILIATE			
SUPERIOR DIAMONDS INC. (i)	18.6	\$ 1,242	\$ 3,202
NOTE RECEIVABLE (ii)	—	200	—
		<u>1,442</u>	<u>3,202</u>
OTHER			
FNX MINING COMPANY INC. (iii)	1.0	3,840	5,701
MAXY GOLD CORP.	10.1	970	2,008
JINSHAN GOLD MINES INC.	1.0	317	539
LAKE SHORE GOLD CORP. (i)	2.5	1,515	4,940
		<u>\$ 8,084</u>	<u>\$16,390</u>

		December 31 2004	
	Ownership %	Carrying Value	Quoted Market Value
SIGNIFICANTLY INFLUENCED AFFILIATES			
AURORA PLATINUM CORP.	15.7	\$ 5,922	\$ 4,702
SUPERIOR DIAMONDS INC.	19.8	618	2,261
NOTE RECEIVABLE	—	200	—
		<u>6,740</u>	<u>6,963</u>
OTHER			
MAXY GOLD CORP.	11.3	970	1,455
JINSHAN GOLD MINES INC.	2.1	317	671
		<u>\$ 8,027</u>	<u>\$ 9,089</u>

(i) In April 2005, the Company purchased 888,889 common shares of Superior Diamonds Inc. ("Superior") at a price of \$0.45 per share totalling \$400,000. The Company also acquired 2 million common shares of Lake Shore Gold Corp. ("Lake Shore") at a price of \$0.75 per share.

(ii) As at December 31, 2005, the Company had in place an unsecured promissory note receivable from Superior in the amount

of \$200,000 due January 15, 2007 and bearing interest at a rate of 6% per annum. Interest income of \$12,000 (September 30, 2004 – \$12,500) has been recorded during the year.

(iii) In June 2005, all of the issued and outstanding shares of Aurora Platinum Corp. (“Aurora”) were acquired by FNX Mining Company Inc. (“FNX”). As a result, Southwestern received 644,133 shares of FNX and accounts for the investment using the cost basis.

During the year ended December 31, 2005, the Company sold 224,626 common shares of FNX which resulted in a gain of \$1,018,480.

(iv) In December 2004, the Company purchased by way of private placement 1,500,000 common shares of Superior at \$0.40 per share for \$600,000.

(v) During 2004, the Company sold its remaining shares of Consolidated Jaba Inc., an investment it had written off in 2002, and recorded a gain of \$108,000.

B) Details of gains on shares issued by, and equity in operations of, affiliated companies for the years ended 2005, 2004 and 2003 are as follows:

	For the year ended December 31, 2005		For the year ended December 31, 2004		For the year ended December 31, 2003	
	Gain on shares issued by affiliated companies (i)	Equity in operations of affiliated companies (ii)	Gain on shares issued by affiliated companies (i)	Equity in operations of affiliated companies (ii)	Gain on shares issued by affiliated companies (i)	Equity in operations of affiliated companies (ii)
AURORA PLATINUM CORP.	\$ –	\$ (27)	\$ 385	\$ 597	\$ 100	\$ 68
SUPERIOR DIAMONDS INC.	414	(191)	152	(139)	74	(1,348)
	\$ 414	\$ (218)	\$ 537	\$ 458	\$ 174	\$ (1,280)

(i) Gains on shares issued by affiliated companies arise when the ownership interest of the Company in a significantly influenced or controlled entity is diluted as a result of share issuances of the investee company. The Company does not receive any cash proceeds (nor is required to make any payments) from these transactions.

(ii) Equity in operations of affiliated companies represents the Company’s share of the net earnings or losses for the reporting period in a significantly influenced company.

7. INCOME TAXES

The provision for income taxes reported differs from the amounts computed by applying the cumulative Canadian federal and provincial income tax rates to the loss before tax provision due to the following:

	2005	2004	2003
CANADIAN STATUTORY FEDERAL INCOME TAX RATE	35%	36%	38%
RECOVERY OF INCOME TAXES COMPUTED AT STATUTORY RATES	\$ 3,339	\$ 6,625	\$ 2,936
EFFECT OF LOWER TAX RATES OF FOREIGN JURISDICTIONS	(1,587)	(1,091)	(530)
NON-DEDUCTIBLE EXPENSES	(1,894)	(4,471)	(155)
NON-TAXABLE PORTION OF CAPITAL TRANSACTIONS	108	199	(203)
VALUATION ALLOWANCE	34	(1,262)	(2,048)
INCOME TAX PROVISION	\$ –	\$ –	\$ –

The approximate tax effect of each type of temporary difference that gives rise to the Company's future income tax assets are as follows:

	2005	2004
OPERATING LOSS CARRY FORWARDS	\$ 9,133	\$ 8,733
TAX VALUE OF ASSETS IN EXCESS OF CARRYING VALUE	4,331	3,899
	13,464	12,632
LESS: VALUATION ALLOWANCE	(13,464)	(12,632)
NET FUTURE INCOME TAX LIABILITY	\$ -	\$ -

At December 31, 2005, the Company had the following loss carry forwards available for tax purposes:

Country	Amount	Expiry
CANADA	\$ 12,951	2006-2015
PERU	\$ 15,373	2006-2009
MAURITIUS	\$ 305	none

8. SHARE CAPITAL

A) ISSUED AND OUTSTANDING

	For the year ended December 31, 2005					
	Number of Shares Issued (000's)	Amount	Treasury Shares (000's)	Amount	Number of Shares Outstanding (000's)	Amount
BEGINNING OF YEAR	42,786	\$ 149,476	-	\$ -	42,786	\$ 149,476
PUBLIC OFFERING	2,450	24,908	-	-	2,450	24,908
PRIVATE PLACEMENT	458	4,442	-	-	458	4,442
OPTIONS EXERCISED	320	875	-	-	320	875
SHARES PURCHASED	-	-	80	778	(80)	(778)
END OF YEAR	46,014	\$ 179,701	80	\$ 778	45,934	\$ 178,923

	For the year ended December 31, 2004					
	Number of Shares Issued (000's)	Amount	Treasury Shares (000's)	Amount	Number of Shares Outstanding (000's)	Amount
BEGINNING OF YEAR	39,122	\$ 107,635	-	\$ -	39,122	\$ 107,635
PUBLIC OFFERING	2,300	38,523	-	-	2,300	38,523
OPTIONS EXERCISED	1,364	3,318	-	-	1,364	3,318
END OF YEAR	42,786	\$ 149,476	-	\$ -	42,786	\$ 149,476

In July 2005, the Company received net proceeds of \$608,346 (US\$500,000) by issuing 57,848 common shares at a price of \$10.62 pursuant to the Antay Property agreement.

In October 2005, the Company received gross proceeds of \$26,460,000 by issuing 2,450,000 common shares to a syndicate of underwriters at a price of \$10.80 per share.

Also in October 2005, the Company completed a private placement whereby Newmont Mining Corporation of Canada Limited purchased 400,000 common shares of Southwestern at a price of \$13.00 per share for proceeds of \$5.2 million. The price included a \$3.33 premium and resulted in \$1,332,000 of the gross proceeds being recorded as a reduction to mineral properties rather than an increase in share capital.

Share issue costs for financings completed in 2005 totalled \$1,592,842.

In May 2005, the Company received regulatory approval of its “Notice of Intention To Make a Normal Course Issuer Bid.” The Company has the option to acquire up to 2 million of its own common shares until May 26, 2006. During 2005, the Company purchased 80,000 shares for total consideration of \$778,144.

In June 2004, the company received shareholder and regulatory approval for a two for one stock split. The shares commenced trading on a split basis on June 15, 2004. All share and per share numbers reflect this change.

In March 2004, the Company received gross proceeds of \$40,825,000 pursuant to the issuance of 2,300,000 common shares at a price of \$17.75 per share to a syndicate of underwriters. Total share issue costs amounted to \$2,301,609.

B) STOCK OPTIONS

Under the Company’s stock option plan there were 3,659,000 options outstanding, of which 3,392,000 were exercisable, at December 31, 2005. The options may be exercisable for a period of up to five years and the exercise price is the volume weight- ed-average trading price for the last five trading days prior to the grant of the option. The Board of Directors determines the time during which any option may vest.

	2005		2004	
	Number of Options (000's)	Weighted- Average Exercise Price	Number of Options (000's)	Weighted- Average Exercise Price
OUTSTANDING AT BEGINNING OF YEAR	2,702	\$ 12.08	2,274	\$ 2.13
GRANTED	1,310	\$ 10.78	1,793	\$ 17.35
EXERCISED/CANCELLED	(353)	\$ 3.29	(1,365)	\$ 2.41
OUTSTANDING AT END OF YEAR	<u>3,659</u>	\$ 12.46	<u>2,702</u>	\$ 12.08
EXERCISABLE AT END OF YEAR	<u>3,392</u>	\$ 12.63	<u>2,702</u>	\$ 12.08

The following table summarizes information about stock options outstanding at December 31, 2005:

Exercise Price Range	Number of Options Outstanding (000's)	Weighted- Average Remaining Years of Contractual Life	Weighted- Average Exercise Price	Number of Options Exercisable (000's)	Weighted- Average Exercise Price
\$1.46-\$10.00	786	2.4	\$ 3.45	756	\$ 3.21
\$10.40-\$13.60	1,239	4.3	\$ 11.06	1,002	\$ 11.21
\$14.95-\$18.38	1,634	3.3	\$ 17.86	1,634	\$ 17.86
	<u>3,659</u>	3.4	\$ 12.46	<u>3,392</u>	\$ 12.63

C) STOCK-BASED COMPENSATION

As a result of 1,309,500 stock options granted, of which 1,042,500 vested, during the year ended December 31, 2005, the Company recorded \$5,435,000 (2004 – \$12,377,000; 2003 – \$728,000) as stock-based compensation expense and included an equivalent amount in contributed surplus. This value was determined using the Black-Scholes option pricing model. A weighted-average grant date fair value of \$4.15 (2004 – \$6.90; 2003 – \$4.00) for each option grant was estimated using the following assumptions: no dividends are to be paid; volatility of 58% (2004 – 47%; 2003 – 96%); risk free interest rate of 3.5% (2004 – 5%; 2003 – 5%); and expected life of 3.5 years (2004 – 3.5 years; 2003 – 5 years).

The Black-Scholes option pricing model utilizes subjective assumptions such as expected price volatility and expected life of the option. Discrepancies in these input assumptions can significantly affect the fair value estimate.

9. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2005, the Company paid remuneration to directors and to companies controlled by officers who are also directors in the amount of \$514,750 (2004 – \$808,781; 2003 – \$520,573). The Company received management fees, which are recorded as other income, totalling \$117,000 (2004 – \$192,000; 2003 – \$240,000) from Aurora, Superior and Lake Shore. These are companies which are related by way of common directors. Due to the transaction between Aurora and FNX described in note 6, Aurora ceased to be a related party during the year. There was also an amount of \$6,194 (2004 – \$17,006) due to Southwestern from the aforementioned companies at December 31, 2005.

10. SEGMENTED INFORMATION

INDUSTRY INFORMATION

The Company operates in one reportable operating segment, being the acquisition and exploration of mineral properties.

GEOGRAPHIC INFORMATION

The Company's only sources of revenue in 2005, 2004 and 2003 arose from interest earned on corporate cash reserves and from a note issued to Superior, and management fees. The Company has non-current assets in the following geographic locations:

	2005	2004	2003
PERU	\$ 8,393	\$ 11,099	\$ 10,175
CHINA	26,990	13,043	3,907
CANADA	8,291	8,154	5,679
ARGENTINA	–	–	1,688
	<u>\$ 43,674</u>	<u>\$ 32,296</u>	<u>\$ 21,449</u>

11. GENERAL AND ADMINISTRATIVE

	2005	2004	2003
CONSULTING	\$ 1,346	\$ 869	\$ 534
SHAREHOLDER INFORMATION	347	367	229
OFFICE	697	700	622
LEGAL AND ACCOUNTING	281	268	192
TRAVEL	261	220	207
SALARIES AND BENEFITS	909	753	636
TOTAL	<u>\$ 3,841</u>	<u>\$ 3,177</u>	<u>\$ 2,420</u>

12. SUPPLEMENTAL CASH FLOW INFORMATION

	2005	2004	2003
TAXES PAID	\$ 31	\$ 37	\$ –
INTEREST RECEIVED	\$ 1,201	\$ 917	\$ 211

13. COMMITMENTS

With respect to its leasehold obligations, the Company has commitments totalling \$1,725,917 over five years (2006 to 2009 – \$363,351 per year; 2010 – \$272,513).

14. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("GAAP")

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP"), which differ in certain respects from accounting principles generally accepted in the United States ("US GAAP"). The material differences between Canadian and US GAAP affecting the Company's consolidated financial statements are summarized as follows:

CONSOLIDATED BALANCE SHEETS

	2005	2004
TOTAL ASSETS UNDER CANADIAN GAAP	\$ 108,174	\$ 82,179
UNREALIZED GAINS ON AVAILABLE-FOR-SALE SECURITIES (E)	7,672	947
DECREASE IN MINERAL PROPERTY COSTS (A)	(34,879)	(23,734)
CUMULATIVE ADJUSTMENT TO EQUITY INVESTMENTS (E)	(4,883)	(4,290)
TOTAL ASSETS UNDER US GAAP	\$ 76,084	\$ 55,102
TOTAL LIABILITIES AND NON-CONTROLLING INTEREST UNDER CANADIAN AND US GAAP	\$ 2,476	\$ 1,623
SHAREHOLDERS' EQUITY UNDER CANADIAN GAAP	105,698	80,556
CUMULATIVE MINERAL PROPERTY ADJUSTMENT (A)	(34,879)	(23,587)
CUMULATIVE COMPREHENSIVE INCOME (D)	7,672	800
CUMULATIVE ADJUSTMENT TO EQUITY IN LOSS OF AFFILIATED COMPANIES (E)	(4,883)	(4,290)
TOTAL SHAREHOLDERS' EQUITY UNDER US GAAP	73,608	53,479
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY UNDER US GAAP	\$ 76,084	\$ 55,102

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

	Cumulative from inception to December 31	Year ended December 31		
	2005	2005	2004	2003
NET LOSS UNDER CANADIAN GAAP	\$ (90,607)	\$ (9,540)	\$ (18,525)	\$ (8,049)
MINERAL PROPERTY EXPLORATION EXPENSE (A)	(34,879)	(11,292)	(8,061)	(3,285)
STOCK-BASED COMPENSATION – CONSULTING (B)	(2,127)	-	-	-
STOCK-BASED COMPENSATION – EMPLOYEES (B)	14,853	4,659	9,510	321
ADJUSTMENT TO EQUITY IN LOSS OF AFFILIATED COMPANIES (E)	(4,883)	(593)	(1,614)	1,152
ELIMINATION OF DILUTION GAIN (G)	(5,597)	(414)	(537)	(174)
NET LOSS UNDER US GAAP BEFORE NON-CONTROLLING INTEREST	(123,240)	(17,180)	(19,227)	(10,035)
NON-CONTROLLING INTEREST	485	-	-	-
NET LOSS UNDER US GAAP	\$ (122,755)	\$ (17,180)	\$ (19,227)	\$ (10,035)
LOSS PER SHARE		\$ (0.39)	\$ (0.46)	\$ (0.28)

CONSOLIDATED STATEMENTS OF CASH FLOWS

		Cumulative from inception to December 31			
		Year ended December 31			
		2005	2005	2004	2003
OPERATING ACTIVITIES					
OPERATING ACTIVITIES UNDER CANADIAN GAAP		\$ (29,222)	\$ (5,154)	\$ (3,959)	\$ (4,322)
EXPLORATION (A)		(79,311)	(10,359)	(10,469)	(4,912)
OPERATING ACTIVITIES UNDER US GAAP		<u>\$ (108,533)</u>	<u>\$ (15,513)</u>	<u>\$ (14,428)</u>	<u>\$ (9,234)</u>
INVESTING ACTIVITIES					
INVESTING ACTIVITIES UNDER CANADIAN GAAP		\$ (94,401)	\$ (9,507)	\$ (12,302)	\$ (4,990)
EXPLORATION (A)		79,311	10,359	10,469	4,912
INVESTING ACTIVITIES UNDER US GAAP		<u>\$ (15,090)</u>	<u>\$ 852</u>	<u>\$ (1,833)</u>	<u>\$ (78)</u>

A) EXPLORATION EXPENSES

Canadian GAAP allows exploration costs to be capitalized during the search for a commercially mineable body of ore. Under US GAAP, expenditures on mineral property costs can only be deferred subsequent to the establishment of mining reserves. Previously for US GAAP purposes the Company had expensed all costs relating to the acquisition of exploration rights and exploration expenditures, in the period incurred. However, during the year ended December 31, 2004, the Company adopted EITF 04-02 which had the effect of reducing its equity loss in Aurora for the year ended December 31, 2005 by \$79,000 (2004 – \$1,534,740).

B) ACCOUNTING FOR STOCK-BASED COMPENSATION

For US GAAP purposes the Company accounts for stock-based compensation to employees and directors, under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), using the intrinsic value based method whereby compensation cost is recorded for the excess, if any, of the quoted market price at the date granted over the exercise price.

As described in note 2, the Company accounts for stock-based awards made to non-employees using a fair value based method in accordance with section 3870 of the Canadian Institute of Chartered Accountants Handbook.

SFAS 123, however, allows the Company to continue to measure the compensation cost of employees and directors in accordance with APB 25. The Company has adopted the disclosure-only provisions of SFAS 123.

The following pro forma financial information presents the net loss for the year and the loss per share had the Company adopted SFAS 123 for all stock options issued to employees and directors.

	Year ended December 31		
	2005	2004	2003
NET LOSS UNDER US GAAP	\$ (17,180)	\$ (19,227)	\$ (10,035)
ADDITIONAL STOCK-BASED COMPENSATION COST	(4,659)	(9,510)	(321)
PRO FORMA NET LOSS	\$ (21,839)	\$ (28,737)	\$ (10,356)
PRO FORMA BASIC LOSS PER SHARE	\$ (0.50)	\$ (0.69)	\$ (0.29)

Using the fair value method for stock-based compensation, additional costs of approximately \$4,659,000, \$9,510,000 and \$321,000 would have been recorded for the periods ended December 31, 2005, 2004 and 2003, respectively. This amount is determined using an option pricing model assuming no dividends are to be paid, vesting occurring on the date of the grant, a weighted-average volatility of the Company's share price of 58% (December 31, 2004: 47%; December 31, 2003: 96%), an annual average risk free interest rate of 3.5% (2004: 5%; 2003: 5%), and an expected life of 3.5 years (2004: 3.5 years; 2003: 5 years)

C) FOREIGN CURRENCY TRANSLATION

The Company has reassessed the functional currency of its foreign subsidiaries. The Company believes that the functional currency under US GAAP and the currency of measure under Canadian GAAP is the Canadian dollar. Currently none of the Company's foreign operations generate revenue or have the ability to arrange for third party financing. All cash resources of the foreign entities are derived from the parent company which has the Canadian dollar as the functional currency. This deter-

mination results in there being no US GAAP to Canadian GAAP difference in this regard.

D) COMPREHENSIVE INCOME

Statement No. 130 ("SFAS 130"), reporting "Comprehensive Income," issued by the Financial Accounting Standards Board establishes standards for the reporting and display of comprehensive income and its components. SFAS 130 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement. The impact of SFAS 130 on the Company's financial statements is as follows:

COMPREHENSIVE INCOME

	Cumulative from inception to December 31	Year ended December 31		
	2005	2005	2004	2003
NET LOSS UNDER US GAAP	\$ (117,947)	\$ (17,180)	\$ (19,227)	\$ (10,035)
OTHER COMPREHENSIVE ITEMS:				
UNREALIZED GAINS (LOSSES) ON				
AVAILABLE-FOR-SALE SECURITIES (E)	7,672	6,725	(5,725)	4,793
COMPREHENSIVE LOSS	\$ (110,275)	\$ (10,455)	\$ (24,952)	\$ (5,242)
NET COMPREHENSIVE LOSS PER SHARE		\$ (0.24)	\$ (0.60)	\$ (0.15)

E) INVESTMENTS

Statement of Financial Accounting Standards No. 115 ("SFAS 115"), "Accounting for Certain Investments in Debt and Equity Securities," classifies investments into three categories based on management's intentions and anticipated maturity dates of the investments. Under these three categories, the Company's investments categorized as "other" in note 6 would be categorized as "available for sale securities." Accordingly, these investments would be carried at the quoted market value and the unrealized gains would be shown as a separate component of shareholders' equity. The investments in note 6 categorized as "significantly influenced affiliates" are accounted for under the equity method for which there is no material difference under Canadian and US GAAP, except that the underlying results of operations are adjusted to conform with US GAAP prior to the calculation of the Company's share of equity income (loss). The significant conforming adjustment to the affiliates' results relates to the accounting for mineral property expenditures.

F) CONTROLLED ENTITIES

The Company operates in China through a majority held subsidiary. Under US GAAP such ventures are accounted for under the equity method as it is considered that the Company cannot exercise sufficient control to warrant consolidation. Under Canadian GAAP it is considered that the rights of the minority do not significantly impair the Company's right to control and direct the operations and therefore the Company has consolidated, on a proportionate basis, the results of operations and financial position. The Company has determined that the effect of this difference on all periods disclosed is immaterial.

G) ACCOUNTING FOR SALES OF SHARES BY AN EQUITY INVESTMENT

The Company accounts for dilution gains and losses from the sale of shares by its equity investments as income statement items for Canadian GAAP purposes. Under US GAAP, dilution gains or losses that arise from a company in the development stage are treated as a charge to equity. For US GAAP purposes, as the Company's equity investments are considered exploration stage companies, the Company has charged all dilution gains to a separate Contributed Surplus account in equity.

H) RECENT U.S. ACCOUNTING PRONOUNCEMENTS

In November 2005, the FASB issued FASB Staff Position (FSP) FAS 115-1 and FAS 124-1 - "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in FSP FAS 115-1 and FAS 124-1 is applicable to reporting periods beginning after December 15, 2005. Management does not expect the adoption of this FSP to have a material effect on the Company's consolidated financial position and results of operations.

In December 2004, the FASB issued SFAS No. 123(R) - "Share-Based Payment," which replaces SFAS No. 123 - "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25 - "Accounting for Stock Issued to Employees." In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 - "Share-Based Payment," which provides interpretive guidance related to SFAS No. 123(R). SFAS No. 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements. With limited exceptions, the amount of compensation cost is measured based on the grant-date fair value of the equity or liability instruments issued. SFAS No. 123(R) requires liability awards to be re-measured each reporting period and compensation costs to be recognized over the period that an employee provides service in exchange for the award. Management plans to adopt this statement on the modified prospective basis beginning January 1, 2006, and does not expect adoption of this statement to have a material effect on the Company's consolidated financial position and results of operations. Subsequent to adoption of this statement, share-based benefits will be valued at fair value using the Black-Scholes option pricing model for option grants and the grant date fair market value for stock awards. Compensation amounts so determined will be expensed over the applicable vesting period.

In October 2005, the FASB issued FASB Staff Position FAS 123(R)-2, "Practical Accommodation to the Application of Grant Date as Defined in FAS 123(R)" ("FSP 123(R)-2"). FSP 123(R)-2 provides guidance on the application of grant date as defined in SFAS No. 123(R). In accordance with this standard a grant date of an award exists if a) the award is a unilateral grant, and b) the key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. The Company will adopt this standard when it adopts SFAS No. 123(R), and does not anticipate that the implementation of this statement will have a significant impact on its results of operations.

In November 2005, the FASB issued FASB Staff Position FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards" ("FSP 123(R)-3"). FSP 123(R)-3 provides an elective alternative method that establishes a computational component to arrive at the beginning balance of the accumulated paid-in capital pool related to employee compensation and a simplified method to determine the subsequent impact on the accumulated paid-in capital pool of employee awards that are fully vested and outstanding upon the adoption of SFAS No. 123(R). The Company is currently evaluating this transition method.

In December 2004, the FASB issued SFAS 153, "Exchanges of Non-Monetary Assets - An Amendment of APB Opinion No. 29." The guidance in APB No. 29, "Accounting for Non-Monetary Transactions," is based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends APB No. 29 to eliminate the exception for exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement will be effective for fiscal periods beginning after June 15, 2005. Earlier application is permitted for non-monetary asset exchanges incurred during fiscal years beginning after the date this Statement is issued. The Company believes this Statement will have no impact on the financial statements of the Company once adopted.

On March 30, 2005, the FASB ratified the consensus of the Emerging Issues Task Force ("EITF") of the FASB Issue 04-6 that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred. This consensus is effective for the first reporting period in fiscal years beginning after December 15, 2005, with early adoption permitted. The consensus can be adopted either prospectively through a cumulative-effect adjustment or retrospectively by restating prior period financial statements. The Company will apply this consensus on its results of operations, financial position and cash flows if and when commercial production commences.

In March 2005, the FASB issued FIN 47, "Accounting for Conditional Asset Retirement Obligation - An Interpretation of FASB 143." FIN 47 provides guidance that an entity must record a liability even if the obligation is conditional upon the occurrence of a future event (e.g. plant shutdown), unless it is not possible to make a reasonable estimate of the obligation. It also provides criteria for determining when an asset retirement obligation may be estimated reasonably. The interpretation is effective no later than the end of fiscal years ending after December 15, 2005. Retroactive application for interim financial information is permitted but not required. The Company will adopt this standard and does not anticipate that the implementation of this statement will have a significant impact on its results of operations.

CONSOLIDATED SCHEDULE OF SHARE CAPITAL SINCE INCEPTION

AN EXPLORATION STAGE COMPANY

FROM INCEPTION TO DECEMBER 31, 2005 (C\$ in thousands)	Common Shares Without Par Value		Treasury Shares		Contributed Surplus	Deficit Accumulated During the Exploration stage	Total Shareholders' Equity
	Shares	Amount	Shares	Amount			
ISSUANCE OF COMMON SHARES FOR CASH	4,392	\$ 541	—	\$ —	\$ —	\$ —	\$ 541
ISSUANCE OF COMMON SHARES FOR EXPLORATION EXPENDITURES	600	75	—	—	—	—	75
NET LOSS	—	—	—	—	—	(296)	(296)
BALANCE, OCTOBER 31, 1991	4,992	616	—	—	—	(296)	320
ISSUANCE OF COMMON SHARES FOR CASH	4,378	884	—	—	—	—	884
NET LOSS	—	—	—	—	—	(270)	(270)
BALANCE, OCTOBER 31, 1992	9,370	1,500	—	—	—	(566)	934
ISSUANCE OF COMMON SHARES FOR CASH	3,350	815	—	—	—	—	815
ISSUANCE OF COMMON SHARES FOR CASH PURSUANT TO PUBLIC OFFERING	1,600	740	—	—	—	—	740
ISSUANCE OF COMMON SHARES FOR CASH ON THE EXERCISE OF WARRANTS	100	50	—	—	—	—	50
NET INCOME	—	—	—	—	—	721	721
BALANCE, OCTOBER 31, 1993	14,420	3,105	—	—	—	155	3,260
ISSUANCE OF COMMON SHARES FOR CASH PURSUANT TO PUBLIC OFFERING	4,200	14,957	—	—	—	—	14,957
ISSUANCE OF COMMON SHARES FOR CASH ON THE EXERCISE OF WARRANTS	570	1,367	—	—	—	—	1,367
ISSUANCE OF COMMON SHARES FOR CASH	1,880	3,330	—	—	—	—	3,330
NET LOSS FOR THE 14 MONTHS ENDED DECEMBER 31, 1994	—	—	—	—	—	(1,027)	(1,027)
BALANCE, DECEMBER 31, 1994	21,070	22,759	—	—	—	(872)	21,887
ISSUANCE OF COMMON SHARES FOR CASH ON THE EXERCISE OF WARRANTS	1,830	8,233	—	—	—	—	8,233
ISSUANCE OF COMMON SHARES FOR CASH	90	45	—	—	—	—	45
NET LOSS	—	—	—	—	—	(1,317)	(1,317)
BALANCE DECEMBER 31, 1995	22,990	31,037	—	—	—	(2,189)	28,848
ISSUANCE OF COMMON SHARES FOR CASH PURSUANT TO PUBLIC OFFERING	7,408	47,346	—	—	—	—	47,346
ISSUANCE OF COMMON SHARES FOR CASH ON THE EXERCISE OF WARRANTS	40	330	—	—	—	—	330
ISSUANCE OF COMMON SHARES FOR CASH	114	622	—	—	—	—	622
NET LOSS	—	—	—	—	—	(1,315)	(1,315)
BALANCE, DECEMBER 31, 1996	30,552	79,335	—	—	—	(3,504)	75,831
ISSUANCE OF COMMON SHARES FOR CASH	2	11	—	—	—	—	11
OWN SHARES PURCHASED FOR CASH PURSUANT TO SHARE PURCHASE PROGRAM	—	—	(158)	(384)	—	—	(384)
NET LOSS	—	—	—	—	—	(3,820)	(3,820)
BALANCE, DECEMBER 31, 1997	30,554	79,346	(158)	(384)	—	(7,324)	71,638
ISSUANCE OF COMMON SHARES FOR CASH	42	28	—	—	—	—	28
OWN SHARES PURCHASED FOR CASH PURSUANT TO SHARE PURCHASE PROGRAM	—	—	(1,838)	(3,787)	—	—	(3,787)
OWN SHARES RESOLD	—	—	600	1,212	426	—	1,638
NET LOSS	—	—	—	—	—	(7,339)	(7,339)
BALANCE, DECEMBER 31, 1998	30,596	79,374	(1,396)	(2,959)	—	(14,663)	62,178
OWN SHARES PURCHASED FOR CASH PURSUANT TO SHARE PURCHASE PROGRAM	—	—	(1,636)	(3,896)	—	—	(3,896)
OWN SHARES RESOLD	—	—	720	1,675	(426)	—	1,249
LOSS ON SALE OF OWN SHARES	—	—	—	—	—	(61)	(61)
NET LOSS	—	—	—	—	—	(10,642)	(10,642)
BALANCE, DECEMBER 31, 1999	30,596	79,374	(2,312)	(5,180)	—	(25,366)	48,828
ISSUANCE OF COMMON SHARES FOR CASH	68	147	—	—	—	—	147
OWN SHARES PURCHASED FOR CASH PURSUANT TO SHARE PURCHASE PROGRAM	—	—	(1,432)	(3,275)	—	—	(3,275)
NET LOSS	—	—	—	—	—	(2,338)	(2,338)
BALANCE, DECEMBER 31, 2000	30,664	79,521	(3,744)	(8,455)	—	(27,704)	43,362
ISSUANCE OF COMMON SHARES FOR CASH	2,254	3,000	—	—	—	—	3,000
OWN SHARES PURCHASED FOR CASH PURSUANT TO SHARE PURCHASE PROGRAM	—	—	(1,030)	(1,633)	—	—	(1,633)
LOSS ON SALE OF OWN SHARES	—	—	3,800	8,541	—	—	8,541
NET LOSS	—	—	—	—	—	(15,650)	(15,650)
BALANCE, DECEMBER 31, 2001	32,918	82,521	(974)	(1,547)	—	(43,354)	37,620
ISSUANCE OF COMMON SHARES FOR CASH	178	364	—	—	—	—	364
OWN SHARES PURCHASED FOR CASH PURSUANT TO SHARE PURCHASE PROGRAM	—	—	(342)	(459)	—	—	(459)
STOCK-BASED COMPENSATION	—	—	—	—	485	—	485
NET LOSS	—	—	—	—	—	(13,872)	(13,872)
BALANCE, DECEMBER 31, 2002	33,096	82,885	(1,316)	(2,006)	485	(57,226)	24,138
ISSUANCE OF COMMON SHARES FOR CASH	7,342	28,046	—	—	—	—	28,046
SHARES CANCELLED	(1,316)	(3,296)	1,316	2,006	1,290	—	—
STOCK-BASED COMPENSATION	—	—	—	—	728	—	728
NET LOSS	—	—	—	—	—	(8,049)	(8,049)
BALANCE, DECEMBER 31, 2003	39,122	107,635	—	—	2,503	(65,275)	44,863
ISSUANCE OF COMMON SHARES FOR CASH	3,664	41,841	—	—	—	—	41,841
STOCK-BASED COMPENSATION	—	—	—	—	12,377	—	12,377
NET LOSS	—	—	—	—	—	(18,525)	(18,525)
BALANCE, DECEMBER 31, 2004	42,786	149,476	—	—	14,880	(83,800)	80,556
ISSUANCE OF COMMON SHARES FOR CASH (EXCLUDING EXERCISE OF STOCK OPTIONS)	2,908	29,349	—	—	—	—	29,349
OWN SHARES PURCHASED FOR CASH PURSUANT TO SHARE PURCHASE PROGRAM	—	—	(80)	(778)	—	—	(778)
STOCK-BASED COMPENSATION	—	—	—	—	5,435	—	5,435
EXERCISE OF STOCK OPTIONS	320	876	—	—	(200)	—	676
NET LOSS	—	—	—	—	—	(9,540)	(9,540)
BALANCE, DECEMBER 31, 2005	46,014	\$ 179,701	(80)	\$ (778)	\$ 20,115	\$ (93,340)	\$ 105,698

CORPORATE INFORMATION

DIRECTORS AND OFFICERS

W DAVID BLACK * † ‡

Chair and Director

JOHN G PATERSON

President, CEO and Director

DANIEL G INNES

Vice President, Exploration and Director

THOMAS W BEATTIE

Vice President, Corporate Affairs and Corporate Secretary

PARKASH K ATHWAL

Vice President, Finance and CFO

TIMO JAURISTO ‡

Vice President, Corporate Development

JAMES B HUME * † ‡ ‡

Director

WILLIAM D MCCARTNEY * † ‡ ‡

Director

* MEMBER OF THE AUDIT COMMITTEE

† MEMBER OF THE COMPENSATION COMMITTEE

‡ MEMBER OF THE ENVIRONMENT AND SAFETY COMMITTEE

* MEMBER OF THE CORPORATE GOVERNANCE AND NOMINATING COMMITTEE

MANAGERS

C RICHARD PETERSEN

Director of Exploration – Latin America

JAVIER SALAS

Director of Exploration – Peru

TAN SHUN DAO

Chief Representative – China

JOHN ZHANG

Manager of Exploration – China

HEAD OFFICE

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510 Burrard Street

Vancouver, British Columbia

Canada V6C 3B9

STOCK EXCHANGE LISTING

SWG – TSX

NOTICE OF ANNUAL MEETING

The annual meeting of shareholders will be held at:

Four Seasons Hotel

791 West Georgia Street

Vancouver, British Columbia, Canada

Friday, May 5, 2006 at 10:00 am



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